S. HRG. 99-1068

# FOREIGN AGRICULTURAL INVESTMENT REFORM

## HEARING

BEFORE THE

SUBCOMMITTEE ON MONETARY AND FISCAL POLICY

AND THE

SUBCOMMITTEE ON
AGRICULTURE AND TRANSPORTATION

OF THE

## JOINT ECONOMIC COMMITTEE
## CONGRESS OF THE UNITED STATES

NINETY-NINTH CONGRESS

SECOND SESSION

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MAY 13, 1986

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# CONTENTS

## WITNESSES AND STATEMENTS

TUESDAY, MAY 13, 1986


| | Page |
|---|---|
| D'Amato, Hon. Alfonse M., member of the Subcommittee on Monetary and Fiscal Policy: Opening statement | 1 |
| Symms, Hon. Steven D., chairman of the Subcommittee on Monetary and Fiscal Policy: Opening statement | 2 |
| Perry, Arlie, vice president, American Soybean Association | 5 |
| Nickles, Hon. Don, a U.S. Senator from the State of Oklahoma | 13 |
| Senter, David, national director, American Agriculture Movement, Inc | 20 |
| Nelsen, Peter, president, International Trade Council | 24 |
| Reynolds, Alan, vice president and chief economist, Polyconomics, Inc | 32 |
| Hallinan, Timothy, former World Bank economist | 36 |
| Craig, Hon. Larry E., a U.S. Representative in Congress from the First Congressional District of the State of Idaho | 53 |
| Ruff, Howard J., chairman of the board, Free the Eagle Citizen's Lobby | 59 |


AFTERNOON SESSION


| | |
|---|---|
| Abdnor, Hon. James, chairman of the Subcommittee on Agriculture and Transportation: Opening statement | 102 |
| Mattingly, Hon. Mack, member of the Subcommittee on Agriculture and Transportation: Opening statement | 103 |
| Boulter, Hon. Beau, a U.S. Representative in Congress from the 13th Congressional District of the State of Texas | 104 |
| True, S.M., Jr., president, Texas Farm Bureau | 116 |
| Nelson, Bill, executive vice president, Texas Wheat Producers Association | 120 |
| Pope, George J., Assistant General Sales Manager and Assistant Administrator, Export Credits, Foreign Agricultural Service, Department of Agriculture | 123 |
| Kramer, Hon. Ken, a U.S. Representative in Congress from the Fifth Congressional District of the State of Colorado | 134 |
| Benson, Naioma, national president, Women Involved in Farm Economics | 137 |
| Galston, William A., director, economic and social programs, Roosevelt Center for American Policy Studies | 140 |
| Paarlberg, Robert L., associate professor of political science, Wellesley College, and associate, Harvard University Center for International Affairs | 151 |
| Hardy, Stuart B., manager, food and agriculture policy, U.S. Chamber of Commerce | 163 |


## SUBMISSIONS FOR THE RECORD

TUESDAY, MAY 13, 1986


| | |
|---|---|
| Conrow, James W., Deputy Assistant Secretary for Developing Nations, Department of the Treasury: Written testimony | 96 |
| Craig, Hon. Larry E.: Statement of Idaho Lt. Gov. David H. Leroy | 56 |
| Emerson, Hon. Bill, a U.S. Representative in Congress from the Eighth Congressional District of the State of Missouri: Statement | 95 |
| Hallinan, Timothy: Prepared statement | 41 |
| Nelsen, Peter: Prepared statement | 26 |
| Nickles, Hon. Don: | |
| Prepared statement | 15 |
| Article entitled "Funding Our Trade Rivals" | 18 |

Page

Perry, Arlie: Prepared statement, together with a press release ..... 8
Ruff, Howard J.: Prepared statement ..... 63
Senter, David: Prepared statement ..... 22

AFTERNOON SESSION

Boulter, Hon. Beau: Prepared statement ..... 108
Galston, William A.: Prepared statement ..... 142
Hardy, Stuart B.: Prepared statement ..... 165
Paarlberg, Robert L.: Prepared statement ..... 155
Pope, George J.:
Response to Senator Abdnor's request for information on the status of 301 cases ..... 127
Letter from the Department of Agriculture, dated February 27, 1986, to the Department of the Treasury regarding the World Bank's proposed $350 million agricultural sector loan to Argentina ..... 132
True, S.M., Jr.: Text of letter, dated April 9, 1986, from American Farm Bureau president Dean Kleckner to Treasury Secretary Baker concerning the U.S.-backed initiative by the World Bank to aid Argentine farmers ..... 118

# FOREIGN AGRICULTURAL INVESTMENT REFORM

TUESDAY, MAY 13, 1986

CONGRESS OF THE UNITED STATES, SUBCOMMITTEE ON MONETARY AND FISCAL POLICY AND THE SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION OF THE JOINT ECONOMIC COMMITTEE,

*Washington, DC.*

The Subcommittee on Monetary and Fiscal Policy met, pursuant to notice, at 9:40 a.m., in room SD-G50, Dirksen Senate Office Building, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senators Symms and D'Amato.

Also present: Joe Cobb, Dale Jahr, Kenneth Brown, Jim Pasero, and Don Terry, professional staff members.

## OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. The subcommittee will come to order.

First of all, I want to commend Senator Symms for calling this important and timely hearing this morning on Foreign Agricultural Investment Reform. Our farmers are experiencing extremely difficult times, and the federal government should not be aggravating their hardships by indirectly supporting the production of foreign agricultural products.

Over the last five years we have seen land prices plummet, farm bankruptcies increase, and commodity prices steadily decline. This crisis now almost reaches Great Depression proportions. For example, the United States' world market share of cotton has dropped from 40 percent in 1980 to 16 percent in 1985. At the same time, the People's Republic of China's world market share has steadily increased from 0.5 percent to 8 percent. Similarly, U.S. exports of soybean meal have declined from 41 percent to 18 percent, while Argentina's market share has increased from 1 percent to 15 percent during marketing years 1980 to 1985. This is not good news for U.S. farmers.

Although an economic analysis of the weak agricultural economy will reveal a high federal budget deficit, a strong U.S. dollar, and huge deficits in the U.S. trade account, it may not reveal the subsidization of foreign farmers by the United States. The International Monetary Fund and the World Bank, institutions financed in part by U.S. taxpayers, make loans to nations to aid them in developing their domestic resources. This low-interest financing, combined

with the high value of the dollar, gives foreign producers a strong competitive advantage over our farmers.

Although my state of New York is not widely known as an agricultural state, it is. The number one industry in New York is agriculture, and one out of every five persons is directly or indirectly employed in agriculture. The recently announced $350 million loan to Argentina by the World Bank will have a direct impact on New York apple growers and grain farmers. Argentine farmers will receive higher prices for their exports of apple juice, corn, and other grains by using the loan to reduce export taxes levied by the Argentine government. With raising his prices on the world market, the Argentine farmer will reap a higher profit.

Our farmers are not afraid of competition. In fact, they invite it. However, it is unfair to ask them to compete against the treasury of a foreign government, and it is simply ludicrous to ask them to compete against the treasury of their own government. The United States provides almost one-third of the funding for the World Bank. We should have enough clout to stop such egregious practices as the ones I've just outlined.

I would like to thank the chairman for calling this subcommittee hearing today. I see he's on his way. I'm sorry that I will not be able to stay for the balance of it since I already have two other hearings that are taking place, but I think this a most important issue. Again, Mr. Chairman, let me thank you for giving us the opportunity to share some thoughts with you on this most pressing problem.

I mentioned, in your absence, Mr. Chairman, that New York is not thought of as an agricultural State, but indeed, it is our number one industry. One out of every five jobs in our state is directly or indirectly a result of agriculture. So we thank you. We share your concern, and I look forward to working with the chairman in attempting to see to it that American taxpayer dollars do not go to the subsidization of the competition that is increasingly cutting into our farm markets. Thank you for holding the hearing, Mr. Chairman.

## OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator SYMMS. Thank you very much, Senator D'Amato, and I think you've said it very well. You know, competition is one thing. We all favor competitive trade, but when we subsidize our own competition that is another matter; and that's what's been happening. So I appreciate your interest in agriculture and I recognize that your state is a very big agricultural state and we will work together.

We passed this bill once and we're going to pass it again through the Senate and again and again until we can finally get our colleagues in the other body to agree to restrict the flow of U.S. taxpayer dollars to support directly the agricultural competition in international agricultural exports.

I thank you very much for your presence here this morning. You have other committee hearings and that's always the case. I have two hearings pending myself this morning, one the Finance Committee and another the Environment and Public Works Committee,

which both require my attendance, but I guess we can't be three places at once so I will stay here.

I will just make a very brief statement and then we will start with the witnesses. Thank you very much, Senator.

Today the Subcommittee on Monetary and Fiscal Policy will receive testimony on current multinational investment policies and their effect on world markets.

This hearing is being held in conjunction with a hearing of the Subcommittee on Agriculture and Transportation to be chaired by my colleague, Senator Abdnor, this afternoon at 2:00 p.m. on the same topic.

Members of Congress have expressed their concern about three areas of current multilateral investment policy—their effect on U.S. producers (primarily farmers), their burden on taxpayers, and their role in the development of foreign countries.

Foreign investment policies have a tremendous impact on my own state of Idaho. Idaho is a "farm state." Of the resource industries that make up the bulk of Idaho's economy, agriculture is responsible for two of every three dollars generated. When farmers in Idaho suffer financially, the economy of the entire state suffers.

Right now, those farms are suffering. The problem is simple. In economic terms, production exceeds demand, which lowers both prices and net farm income. Congress has recently been faced with a decision on how best to solve the problem. During the debate on the 1985 farm bill, two options were presented: (1) limit production through mandatory controls; or (2) increase demand by expanding U.S. exports. We chose to increase exports.

Expanding U.S. export markets, however, was certainly not the easy choice. A successful export policy totally depends on the competitiveness of U.S. producers. We can no longer be the supplier of last resort. In a highly competitive world market, that is a losing position. The 1985 farm bill expresses Congress' optimism and faith in the inventiveness and productivity of American farmers. We're facing world competition with the challenge "may the best man win."

But what if the world market is so contorted that the best man doesn't win? The Achilles' heel of an export-oriented policy is international investment that does not adhere to market principles. Supposedly, shrewd financiers will not invest in farm production already in surplus, such investments rarely being profitable. Unfortunately, multilateral banks today do not follow this logic, and the result is a world market where everyone loses.

Multilateral banks were created to improve the quality of life in developing countries. Education, health care, and other such investments are, in fact, justifiably in the United States best interest. Better-educated and healthier third world countries contribute more to the world economy and, at the same time, demand more American goods and services.

Unfortunately, international financing in recent years has not focused on improving the quality of life. As countries began to stumble under staggering debt loads, the spectre of default caused banks to concentrate more and more on obtaining repayment. Financing today is more often than not targeted at generating an im-

mediate hard currency return, often taking the form of agricultural export expansion.

Thus, we have a new competitor for world agricultural markets: countries who must export in order to finance debt, even if at high cost to its own domestic economy. How can American farmers compete against such "kamikaze" farm exports?

During the recent economic summit in Japan, world leaders announced that domestic farm policies of developed countries must be reformed. I commend them for their sense of the obvious. Making those reforms work in a distorted world economy is a different story. How can I defend a policy to turn Idaho farmers loose on world markets, when their own tax dollars are being used to create subsidized export competition which would not exist in a truly free market?

I hope in this hearing that we will be able to determine the effect of these artificially stimulated agricultural exports on American farmers. Congress has expressed strong disapproval of such policies in the past, an expression that has fallen on deaf ears within the multilateral banks.

Several years ago, my colleague from Utah, Senator Garn, successfully passed legislation to prevent multilateral financing of copper, a commodity which was then and still is currently in surplus. His amendment required the United States executive directors of international financial institutions to vote against all such loans. To my knowledge, that provision has yet to curtail a single loan for copper production.

There is no time now for me to sermonize on the need for the federal government to show fiscal constraint. It seems obvious to me that tax dollars leaving the treasury at a rate of over a billion per year ought to be more carefully scrutinized.

I am not calling into question all loans or forms of international aid. There are many investments that do return a profit to struggling foreign countries. But can farm exports in surplus markets be one of them? By definition, such products are rarely sold on world markets for more than production costs. Countries must in many cases subsidize their sales. Every subsidy dollar coming out of a nation's economy is a dollar that will not be used for education, health care or any other improvement in living standards.

Many of these loans are accompanied by severe austerity measures that require tight control of imports. This protectionism also raises costs to domestic consumers and lowers their standard of living; not to mention the impact it has on our own exports.

It concerns me that billions of U.S. tax dollars are allocated to banks which have so little responsibility to the people of the United States. The World Bank and the IMF could devastate American farmers and yet remain completely unanswerable to the American public.

For American agriculture to survive, it must be able to compete in world markets. If multilateral lending policies are defeating this purpose, corrective action must be taken—even at the expense of international institutions. The federal government, after all, is obligated first to the needs of the American public.

Perhaps a policy that devastates American agriculture could be justified if it provided some great humanitarian relief to some

other part of the world. That, of course, is arguable. However, policies that benefit neither the U.S. nor developing countries seriously violate the principles of good government, and the trust of the people. This hearing I hope will help determine if such policies are in force, and if so, what changes, if any, should be made.

We welcome the witnesses this morning. Senator Nickles is not here yet. Mr. Perry, of the American Soybean Association.

Mr. Perry, I understand you're from Oklahoma and I know Senator Nickles wished to join you at the dias this morning. Why don't you go ahead with your statement and then when Senator Nickles gets here we will let him join you and make some comments also. He's a co-sponsor of this legislation. We're delighted to have you, Mr. Perry.

## STATEMENT OF ARLIE PERRY, VICE PRESIDENT, AMERICAN SOYBEAN ASSOCIATION

Mr. PERRY. Thank you very much, Mr. Chairman.

Senator SYMMS. Do you have a prepared statement?

Mr. PERRY. Yes, I do.

Senator SYMMS. Go ahead. Welcome to the subcommittee.

Mr. PERRY. Thank you. I am Arlie Perry, a farmer from Fort Gibson, Oklahoma, and I'm also a vice president of the American Soybean Association.

ASA does strongly support the Foreign Agricultural Investment Reform Act that we're talking about this morning and we think it's high time for Congress to insist that America's contributions to the World Bank and other international lenders not be used against our own farmers.

As an Oklahoman, I would like to especially commend my own Senator, Don Nickles, for his role in FAIR.

For some years, ASA has questioned the philosophy behind many World Bank loans. To understand our concern, I think you need to understand the nature of the American soybean industry as a whole. When I plant my soybeans this spring, which will be in a couple of weeks, one row out of every two that I plant will be planted for the export market. Soybean farmers are committed to world markets.

There was a time when the U.S. completely dominated the world soybean trade but those days are gone. The 1973 embargo on U.S. soybean exports spurred Brazil and Argentina to develop their soybean industries, and the high dollar in the 1980s hasn't helped that situation at all. I think here's what's happened to our positions in the market recently.

As has been mentioned, in 1979, the U.S. accounted for 50 percent of all soybean meal exports, while Brazil and Argentina, our competitors to the south, combined had a 40 percent share. By 1984, Brazil and Argentina had 60 percent of the world market while we had less than 30 percent.

In 1979, the U.S. soybean oil accounted for between 15 and 20 percent of the total world vegetable oil trade, while Brazilian and Argentine soybean oil had less than a 10 percent share. But by 1984, the South Americans' share approached 20 percent while the U.S. share was only 10 percent.

In 1979, the U.S. had nearly 90 percent of the world soybean market as a whole and Brazil and Argentina accounted for a little over 10 percent. But by 1984, the U.S. market share had shrunk to about 75 percent with our South American competitors taking close to 25 percent of the world market.

So Brazil and Argentina now occupy the same position of dominance in soybean product trade that the U.S. once held. Our position in the soybean market itself is no where near what it once was. There, too, we've lost market share to Brazil and Argentina as I've just mentioned.

Soybean farmers I think understand that we live in a competitive world. We accept that fact. What bothers us is when our own government takes actions that directly help foreign countries compete with us in world oilseed markets. Unfortunately, that does happen.

For example, between 1965 and 1975, the World Bank, the Inter-American Development Bank and the Asian Development Bank made 32 loans totaling over $300 million for palm oil production in developing countries. Today there is a worldwide glut of palm oil and U.S. imports of palm oil this year will be 75 percent greater than last year just because it's become cheaper than soybean oil. Why is it cheaper? Because there's too much palm oil production capacity in the world today.

Earlier this year, the World Bank approved a 15-year, variable interest loan to Brazil for $200 million to improve the railroad systems and to facilitate the export of grains from several of the Brazilian states which also happen to be top soybean-producing areas.

Just last month, the World Bank approved a $350 million structural loan to Argentina aimed specifically at increasing Argentine exports of soybeans, corn, wheat, sorghum, sunflowers and other agricultural products.

I'd like to quote briefly from the World Bank's press release announcing that last loan. The basic idea behind the loan was to encourage Argentina to lower its export taxes. That means that crops like soybeans and grains are going to become more profitable, and more of them will be grown and in turn exported in competition with the United States.

The press release says that "Argentina's agricultural sector has been growing below potential despite technological advances" and other factors. Then it says that the reforms associated with this loan will "stimulate agricultural production and exports . . . . Major farm exports such as wheat, maize, sorghum, soybeans and sunflower will be offered."

The press release projects $1 billion a year in added exports for Argentina by 1989—that's just three years from now—because of these "reforms."

Mr. Chairman, our government, through its participation in the World Bank, is helping lend money to the Argentine government so Argentina can export more soybeans at a time when U.S. soybean exports are still weak and U.S. soybean prices are below break-even for most farmers. I have to ask why? Does the World Bank think about U.S. farmers when it makes these loans? Does the U.S. government think about us when it supports these kinds of loans?

Finally, I guess I have to admit it's a little galling to think that this loan is for 15 years, with a three-year grace period, at a variable interest rate that's currently 8.5 percent. In Oklahoma, farmers are paying 12 to 14 percent to borrow money and there is certainly no grace period for us.

I want to make it very clear that the American Soybean Association does not oppose multilateral lending to developing countries. We do think it's foolish for our government to support loans that increase the production of agricultural commodities already in surplus, loans that will artificially increase world production and lower world prices.

I might add that a study the Joint Economic Committee released this weekend shows the damage that would be done to U.S. agriculture through this very process.

The Foreign Agricultural Investment Reform Act would put a stop to U.S. support for these kinds of loans. I think it makes a lot of sense because it requires the government to use taxpayer dollars wisely, it gives a fair shake to U.S. farmers, and it gets the U.S. out of the business of encouraging surplus agricultural production overseas.

I'd like to thank you, Mr. Chairman, for your attention and if you have any questions I'd be glad to attempt to answer any questions you might have.

[The prepared statement of Mr. Perry, together with the press release referred to, follows:]

## Prepared Statement of Arlie Perry

Mr. Chairman, I'm Arlie Perry, a farmer from Fort Gibson, Oklahoma. I serve as a vice president of the American Soybean Association, a national non-profit organization of and for soybean farmers. We have members in 29 states and are supported by some 425,000 farmers who invest their money through voluntary checkoff programs to develop foreign markets.

The American Soybean Association strongly supports the Foreign Agricultural Investment Reform Act (S. 1810/H.R. 3643). We think it's high time for Congress to insist that America's contributions to the World Bank and other international lenders not be used against our own farmers. As an Oklahoman, I want to especially commend my Senator, Don Nickles, for his role in crafting the FAIR Act.

For some years, ASA has questioned the philosophy behind many World Bank and IMF loans, as well as certain actions by agencies of our own government. To understand our concern, you need to understand the nature of America's soybean industry.

When I plant my soybeans this spring, one row out of every two will be planted for the export market. When you combine whole soybean exports with exports of soybean meal and soybean oil, nearly half of each year's 2 billion bushel soybean crop is destined for overseas shipment.

There was a time when the U.S. completely dominated world soy trade. Those days are gone. The ill-advised 1973 embargo on U.S. soybean

exports spurred Brazil and Argentina to develop their soybean industries, and the high dollar in the 1980s hasn't helped. Let me give you a few examples of what's happened to our position in the markets:

- In 1979, the U.S. accounted for 50 percent of all soybean meal exports, while Brazil and Argentina combined had a 40 percent share. Beginning in 1980, the South American market share surpassed ours, and by 1984 Brazil and Argentina had 60 percent of the world market while we had less than 30 percent.

- In 1979, U.S. soybean oil accounted for between 15 and 20 percent of total world vegetable oil trade, while Brazilian and Argentine soybean oil had less than a 10 percent share. (The balance was made up by competing oils such as palm, rapeseed and sunflower oil.) But by 1984, the South Americans' share approached 20 percent while the U.S. share was only 10 percent.

- In 1979, the U.S. had nearly 90 percent of the world soybean market, and Brazil and Argentina accounted for a little over 10 percent. In 1984, the U.S. market share had shrunk to about 75 percent with our South American competitors taking close to 25 percent.

In short, Brazil and Argentina now occupy the same position of dominance in soybean product trade that the U.S. once held. Our position in the soybean market itself, though still dominant, is nowhere near what it once was. There too we've lost market share to Brazil and Argentina.

Soybean farmers understand we live in a competitive world. We accept that. What bothers us is when our own government takes actions that directly help foreign countries compete with us in world oilseed markets. Unfortunately, that does sometimes happen. For example ...

- Between 1965 and 1975, the World Bank, the Inter-American Development Bank and the Asian Development Bank made 32 loans totaling over $300 million for palm oil production in developing countries. Of those loans, 20 were approved after 1970. Today, there is a worldwide glut of palm oil, and U.S. imports of palm oil this year will be 75 percent greater than last year because it's become cheaper than soybean oil. Why is it cheaper? Because there's too much palm oil production capacity in the world. Much of that capacity was financed at interest rates below what were available in the U.S.

- Earlier this year, the World Bank approved a 15-year, variable interest loan to Brazil for $200 million to improve the railway systems in and facilitate export of grains from the states of Parana and Mato Grosso, and from the Cerrados region of Brazil -- all top soybean-producing areas.

- Just last month, the World Bank approved a $350 million structural loan to Argentina aimed specifically at increasing

Argentine exports of soybeans, corn, wheat, sorghum and sunflower.

I'd like to quote briefly from the World Bank's press release announcing that last loan. The basic idea behind the loan was to encourage Argentina to lower its export taxes. That means crops like soybeans and grains are going to become more profitable -- and more of them will be grown and in turn exported in competition with the U.S.

The press release says that "Argentina's agricultural sector has been growing below potential despite technological advances" and other factors. Then it says the reforms associated with this loan will "stimulate agricultural production and exports ... Major farm exports such as wheat, maize, sorghum, soybeans and sunflower will be offered."

The press release projects $1 billion a year in added exports for Argentina by 1989 because of these "reforms." A copy of the press release is attached to my statement for the committee's information.

Mr. Chairman, our government, through its participation in the World Bank, is helping lend money to the Argentine government so Argentina can export more soybeans at a time when U.S. soybean exports are still weak and U.S. soybean prices are below break-even for most farmers. I have to ask, why? Does the World Bank think about U.S. farmers when it makes these loans? Does the U.S. government think about us when it supports them?

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The Foreign Agricultural Investment Reform Act would put a stop to U.S. support for these kinds of loans. I think it makes a lot of sense because it requires the government to use taxpayer dollars wisely, it gives a fair shake to U.S. farmers and it gets the U.S. out of the business of encouraging surplus agricultural production overseas.

Thank you for your attention. I'd be glad to attempt to answer any questions you may have.

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BANK NEWS RELEASE NO. 86/68
April 3, 1986

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## ARGENTINA EMBARKS ON REFORM OF ITS AGRICULTURAL SECTOR

### World Bank Lends Support with Loan of $350 Million

Argentina is launching the first phase of a comprehensive reform program designed to increase agricultural production and exports with the help of a World Bank loan of $350 million.

The loan is the first of several Bank lending operations planned in the near future to assist Argentina in tackling economic distortions.

The agricultural sector reforms supported by the Bank loan include a reduction in export taxes on agricultural products and an increase in domestic producer prices. They will also include a structural reform of the taxation system through the introduction of a production-neutral federal land tax; fiscal measures to keep budget deficits at satisfactory levels; and modification of regulations and tariffs pertaining to the import of agricultural inputs.

Estimates are that these reforms will help Argentina earn an additional $1 billion a year in foreign exchange by 1989.

Argentina's agricultural sector has been growing below potential despite technological advances, the existence of a well developed input distribution system, and a highly competitive marketing environment. This has been largely the result of pricing policies. Domestic prices for agricultural products have been kept low through export taxes while the cost of inputs has been kept high through import tariffs. As a consequence most farmers had little incentive to adapt new technologies to help increase production. Average wheat yields, for instance, were 70 percent of those in the United States during the 1980-82 period.

The government is launching the sectoral reforms to stimulate agricultural production and exports as part of its broader strategy to put the country again on the growth path. Major farm exports such as wheat, maize, sorghum, soybeans and sunflower will be offered.

In addition to the transfer of resources in support of policy reform, the Bank loan will finance technical assistance and studies looking towards institutional improvement. These studies include: development of marketing and production strategy; technical and economic feasibility of tubewell irrigation in the maize production region; structural changes in the livestock industry in The Pampa region; and development and promotion of agricultural and agro-industrial exports.

NOTE: Money figures are expressed in U.S. dollar equivalents.

The loan will be administered by the Central Bank, except for the technical assistance component which will be transferred to the relevant agencies. The loan will be released in two tranches. It is expected to be fully disbursed by January 1987 based on the progress of agreed reforms.

The loan is for 15 years, including three years of grace, with a variable interest rate, currently 8.5 percent, linked to the cost of the Bank's borrowings. It also carries an annual commitment charge of 0.75 percent on undisbursed balances.

Senator SYMMS. Thank you very much, Mr. Perry, for an excellent statement.

What was it you said about Senator Nickles before he got in the room?

Mr. PERRY. I'm afraid I can't repeat that, but I certainly do consider it an honor to have Senator Nickles working on such a bill that would help agriculture especially in our state.

Senator SYMMS. Senator Nickles, we are delighted to have you here. He was bragging on you in your absence.

## STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator NICKLES. Well, thank you, Mr. Chairman, and I likewise would like to return the favor and brag on Mr. Perry. He's been certainly a leader in agriculture in my state and in this country and we have fought some battles together, some successful, some not successful—cargo preference and others—and he's vice president of the American Soybean Association and also he's been president of the Oklahoma Soybean Association. He's also a director of the Oklahoma Farm Bureau. So he certainly is a leader in agriculture and he's done his homework and I compliment the American Soybean Association for the work that they have done in helping us and others realize that we've got some very serious problems in American agriculture and especially we have greater problems when we find out that the federal government subsidizes our competition.

Mr. Chairman, I compliment you because certainly you have been a leader in this effort as well and I think the legislation which we jointly introduced, the Foreign Agricultural Investment Reform Act, which we commonly call the FAIR Act, is legislation that needs to be passed. It's very unfortunate that once we got that adopted in the Senate farm bill that that was one of the items that was deleted in conference. I think it's awfully important that we work aggressively and use whatever means or vehicles that we can to see if we can't get it adopted as soon as possible.

Do we have a vote?

Senator SYMMS. Well, I just got the staff to check and it looks like we have a vote. I didn't know there was one scheduled that early.

Senator, I appreciate your support on this and you have been an enthusiastic supporter. I wanted to ask you a question or two and I'd like to ask Mr. Perry, too.

Senator NICKLES. Mr. Chairman, before you do that, can I make a couple of comments?

Senator SYMMS. Oh, certainly. Excuse me. I didn't mean to cut you off.

Senator NICKLES. I have a full statement and I ask that it be inserted in the record but I'd like to make just a couple of comments.

I think this measure is aptly named. Farmers and ranchers are searching for fairness in international markets and taxpayers are searching for a fair return on their investment. Current lending practices of international financial institutions denies American farmers and taxpayers the fairness that they deserve.

While Oklahoma farmers are going through the most difficult economic times since the Great Depression, their own tax dollars are being used to subsidize their foreign competitors. This is an outrageous public policy situation.

On the one hand, we are trying desperately to boost the economic condition of American agriculture, and on the other hand, we are providing direct subsidies to our own farmers' competition. That's totally absurd.

I have previously stated that the experts' economic theories on why our farmers haven't been more successful competing in the world market will do little good until we solve the problem we are discussing today.

The value of U.S. agricultural exports has fallen by over one-third since 1981, from $43 billion to $29 billion last year. In increasing volume, many countries are exporting their excess farm products around the world at subsidized prices made possible by the low interest loans from the international financing institutions.

A review of the 1981 through 1985 annual reports of many of these huge lenders reveals some telling facts. Among those that include loan rates in their reports, rates ranged from a high of almost 10 percent to a low of less than one percent. In 1982, the only year interest rates reached 10 percent, only 27 percent of the loans were above 4 percent. The rest were financed at one to two percent with an average loan life of 35 years.

Mr. Chairman, you offer those kind of interest rates to America's farmers and ranchers today and there would be a dramatic change in the nation's farm economy.

Our farmers, as Mr. Perry indicated before, in Oklahoma are paying around 13 or 14 percent and yet for our government to turn around and indirectly, through a multi-national lending institution, give our competitors one percent money or two percent money for four percent money so they can compete with us, not to mention the fact that they have lower labor costs, etc., is just outrageous and it is really upsetting. It upsets me. Our country happens to be broke. We have enormous deficits yet we turn around and give these multinational lending groups cheap money so they can turn around and subsidize our competitors where there is already a surplus in many of these commodities, whether it be soybeans or wheat or corn, or any of our major grains. So again, we turn around and give low interest money for our competitors to increase world production, which is already a glut, and we're working like the devil to figure out how we can reduce our excess capacity, our excess surplus, and move it out of our country where it is depressing prices. To give these low interest loans is ridiculous and needs to be stopped.

I again compliment you for your leadership and I was happy to join with you in the introduction of this and inclusion of it in the farm bill, when you look back at the farm bill it just really irritates me to see that this was not included in the final package, that it was dropped in conference. It shouldn't have been and I pledge to you that I will work as aggressively as I can to see if we can't find a proper vehicle to get this through as quickly as possible.

[The prepared statement of Senator Nickles follows:]

## Prepared Statement of Hon. Don Nickles

MR. CHAIRMAN: It is indeed my pleasure to be here today to provide input on legislation we introduced last fall, S. 1810, The Foreign Agricultural Investment Reform Act, which we call the FAIR Act.

I think this measure is aptly named. Farmers and ranchers are searching for fairness in international markets and taxpayers are searching for a fair return on their investment. Current lending practices of international financial institutions denies American farmers and taxpayers the fairness they deserve.

While Oklahoma farmers are going through the most difficult economic times since the Great Depression, their own tax dollars are being used to subsidize their foreign competitors. This is an outrageous public policy situation.

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Mr. Chairman, you offer those kind of interest rates to America's farmers and ranchers today and there would be a dramatic change in the nation's farm economy.

If we stand by and continue to fuel foreign agriculture expansion at our expense--at our farmers' expense--any new domestic farm policies will continue to bring less than advertised. We must initiate a well-rounded approach to solving the farm crisis. Until we address the shortcomings in our foreign loan policies, our farmers will never get a FAIR shake.

Senator SYMMS. I thank you for an outstanding statement and I think you speak for a lot of us when you voice this frustration that we feel on this. I happen to farm in Idaho with my family and the patriarch of our family now is 86 years old, my dad, and he for years has said, "You boys can't farm if you're going to be paying more than about six percent interest rates. You'll end up getting too far in debt and it won't work out for you." Then we find out that we're actually lending lower interest money to our competition. If our farmers could get one of these World Bank loans, our problems would be solved. We could operate very nicely on a 4 percent loan and we would have no problems. A one or two percent loan would be even better. I just think it really truly is outrageous and you, Mr. Perry, have had a lot of contact with a lot of different farmers all up through the entire farm belt. Do you find that farmers in general are frustrated and upset about these multinational investments?

Mr. PERRY. Mr. Chairman, we certainly do. I've had contact with farmers from many states for about three years and we've found this to be a concern among many, especially those that know about it. Some of them are not even aware that it's happening, but those that know of it feel it's a frustrating thing that we'll lend money to our competitors to compete against us at a much reduced interest rate.

Senator SYMMS. Well, as a member of the soybean growers and U.S. Soybean Association which was a forefront leader in agricultural exports without government support or help, it's very hard for you to sell to farmers the idea of a free market. I advocate a free market philosophy, to tell them we need to be growing for the market when they have to go head to head and compete against government subsidized state encouraged farming is difficult. Isn't that a true statement?

Mr. PERRY. Yes, it is. Of course, we are certainly advocates of the free market system yet sometimes we find it a little difficult to really believe that there can ever be a free market system as long as these things exist.

Senator SYMMS. I guess you find the same thing out in Oklahoma?

Senator NICKLES. Mr. Chairman, I'll just make a comment. A lot of governments, including our own, subsidize various portions of our agricultural economy. Soybeans happen to be one area where the government input or subsidy has been minimal, if anything. Then when you look at a soybean farmer not only competing with other countries and maybe that country is subsidizing their farmers, but also competing against our own government subsidizing other countries' farmers, that's really doubly bad. I mean, worldwide competition in soybeans—we export a high percentage of our soybeans and in Oklahoma we export 80 percent of our wheat—is increasing rapidly. So it's one thing to compete against another country and other countries' farmers. Our farmers head to head can stand up with any other farmers anywhere in the world, but then when you find out you're competing with that farmer's government and then when you find out that our government sometimes is helping assist that process and so you're not only compet-

ing against that farmer, his government, but also our government, that's too much to handle.

Therefore, we find that we lose some of those markets. It's not fair. You mentioned that 6 percent range. It's not fair for our farmers when we're looking at trying to compete and our farmers are paying 13.75 percent right now in the Federal Land Bank System. We just had a big meeting in Enid, Oklahoma last week. I met with a couple hundred of them, several of them are going through foreclosures because they can't meet that 13.75 percent. The number of foreclosures in our state has risen dramatically.

And yet when you find that our government contributes to the IMF or the International Development Agency or something and they turn around and give one percent or two percent money to our competitors it's just absurd and it needs to be changed and I appreciate your willingness to bring this to the forefront and maybe if we can make more people aware of it it will increase public pressures to the extent that we will be successful in changing policy.

Senator SYMMS. I totally agree with you. As a matter of fact, if you recall, when we had the one vote we have had on this on the Senate floor, the vote was 65 to 13. So I think that the support is there because common sense just simply tells us that this is totally blatantly unfair and it should be stopped.

Did you want to make one more comment, Mr. Perry?

Mr. PERRY. Yes, Mr. Chairman. I'd like to make it clear that the ASA does not want the U.S. to stop lending to third world countries and leave them in poverty. That's not our point at all. I have said in my testimony that we don't oppose lending to developing countries.

What we are against is these loans that encourage production of agricultural commodities which are already in surplus and then compete at low prices with U.S. products when U.S. farmers have to pay these high interest rates that the Senator just mentioned and sell at prices that are below the cost of production. That's not our point. We are not opposed to the lending to third world countries to keep them out of poverty.

Senator SYMMS. Thank you very much, both of you.

Senator NICKLES. Mr. Chairman, I also have an article that I'd like to have included in the record by Mr. Dornan of the Washington Times on December 4.

Senator SYMMS. Without objection, so ordered.

[The article referred to follows:]

[From the Washington Times, Wednesday, Dec. 4, 1985]

*James E. Dornan is an economist with the House Republican Study Committee.*

**JAMES DORNAN**

# Funding our trade rivals

It isn't news that American industries are being hurt on the world market and at home by a flood of new exports from less-developed countries. However, many of these exports are produced with low-interest, easy-term loans from the International Monetary Fund, and other multilateral development lending institutions.

What's really shocking is that the United States contributes about 20 percent of the IMF's budget and a similar percentage to the others. In effect, the United States is subsidizing foreign industries whose exports directly compete with American companies.

The lending policies of the IMF and the other banks have helped create this foreign export flood. When they lend money to a country in economic trouble, they strongly suggest that it earn foreign currency by increasing its exports while limiting its imports. In the process, the United States is hit with a one-two punch; we lose a market for our goods, and new foreign goods pour into the United States and onto world markets.

Even more appalling, these organizations have become more directly involved in economic planning by strongly recommending how the money is spent and which projects are built. The projects being developed are not necessarily the most economically sound and are often short-term ventures that fail and must be bailed out to save the initial investment.

Our textile industry is one that is being especially hurt. A House Appropriations Committee report last year noted the vulnerability of the U.S. textile and apparel industry to imports. It recommended that the U.S. delegates to the multilateral development banks strongly oppose loans for textile and apparel projects that would result in additional imports. The committee blamed the World Bank and the other regional developmental institutions for contributing to this import flood by providing subsidized funds to developing countries to expand their textile exports.

U.S. agriculture has also been hurt by this lending practice. The U.S. share of the world wheat and wheat-flour market fell from 39 percent in 1978 to 36 percent in 1984. Other products have taken a beating on the world markets and in this country as well. U.S. exports of coarse grains have dropped from 61 percent to 56 percent as a share of world markets in the past five years. Rice has dropped from 21 percent to 18 percent. And the U.S. share of the world soybean market has dropped a whopping 10 percent in just four years.

Much of this decrease in the U.S. market share has been blamed on the fact that many countries are becoming more agriculturally self-sufficient.

While this may be true, a very alarming trend has surfaced. Many of these countries now are exporting their excess farm products to the United States and around the world at lower subsidized prices made possible by loans from the multilateral lending institutions.

The other trend is even more frightening; these countries are diverting the money from crops for domestic consumption needs to cash crops for international sale, in order to obtain foreign capital for other purposes.

Last year, China received a credit of $50 million from the International Development Agency for livestock and citrus production. The terms were very generous: less than 1 percent interest over a 50-year period with a 10-year grace period. U.S. imports of certain Chinese meat products have grown by 30 percent since June 1984.

Hungary received an International Bank for Reconstruction and Development loan this year for $80 million to enhance livestock exports. It was given at 9.3 percent over 18 years. U.S. imports of Hungarian meat had already increased by 36 percent in the year prior to that loan.

In 1983, Brazil got a general IBRD loan of $400 million for agricultural-sector development. The terms were 11 percent over an 18-year period. *Since then, Brazil's farm exports to the United States have increased 67 percent* (emphasis Mr. Dornan's).

Congress has tried to deal with this problem before. In 1983, Congress approved an increase in the annual amount given by the United States to the IMF. Republican Sen. Jesse Helms of North Carolina offered an amendment that would have had the IMF deny loans to any nation that refused to eliminate direct or indirect "predatory export subsidies" for agricultural goods. The Helms amendment would have suspended U.S. participation in the IMF if these subsidies were not fully eliminated by Jan. 1, 1985, but it was defeated in the Senate and nothing similar was even offered in the House.

It's ironic that members who supported the IMF funding-increase are now supporting protectionist legislation aimed at the countries the IMF is supposed to be helping.

Recently, legislation has been introduced by two freshman House members whose industries are taking a beating on the world and domestic markets. Republican Rep. Howard Coble of North Carolina has introduced a bill that would remove the U.S. share of the contribution to any of these multilateral lending institutions if the money is to go to the

production of fibers, textiles, or articles of apparel in a foreign country. Republican Rep. Beau Boulter of Texas has introduced similar legislation dealing with agricultural products. Mr. Boulter's bill would have the U.S. representative to these institutions first vote agaist the proposal, then remove the funds contributed if the loan were approved.

Republican Sen. Steve Symms of Idaho, sponsor of a Senate version of the Boulter bill, argues that if we cannot compete, the fault may lie in the international banking policies of this country. Says Mr. Symms, "Subsidizing foreign production in an already surplus market is an inexcusable waste of resources. Many of these investments are driven more by the opportunity to acquire dollars at bargain interest rates than by actual market demand. Using these same dollars to reduce our deficit would be vastly more productive."

Some members of Congress have criticized the use of this threat as counterproductive to overall American policy. They argue that this country has the responsibility to continue to finance the industrial and agricultural growth of Third World countries.

The problem with that argument, though, is that while we are trying to help poorer countries, we are hurting our own people. Our own interests should not be damaged in order to serve the interests of other countries.

The actions of the IMF and other multilateral lending institutions are intended to repair damaged economies. But the result has been a disaster for American industries. The United States is always the country that is most hurt by this lending. In addition to losing overseas markets for our goods, we are losing a portion of our domestic market to subsidized products from Third World countries.

Critics of this lending practice also point out that funding of foreign subsidization through these multilateral lending institutions imposes other costs on the Unites States. President Reagan has been forced to propose a $300 million war chest to deal with countries that subsidize their exports to this country. *Essentially, the United States is subsidizing our industries so they can compete with foreign countries whose industries we subsidize through the IMF, the World Bank, and these other lending organizations* [emphasis Mr. Dornan's].

The Symms/Boulter and Coble solutions are sound. The bills contain an effective remedy. Threatening to cut our contribution will force these lending institutions to take into consideration U.S. policies and needs. We should not spend U.S. tax dollars to subsidize activity that hurts American taxpayers. By reducing the funding for specific projects, we are no longer responsible for hurting our own industries and their workers. We are not interfering with free trade nor abandoning any of the principles on which this country stands.

Senator SYMMS. And you're welcome to join me at the podium if you'd like to.

Senator NICKLES. Thank you very much.

Senator SYMMS. Thank you very much, Mr. Perry, for excellent testimony and also Senator Nickles.

Our next witnesses will be Mr. David Senter, American Agriculture Movement; and Mr. Peter Nelsen, International Trade Council, if those two would please come up.

Mr. Senter, will you please give us your statement. Welcome to the subcommittee. We are glad to have you here. Where is your home?

Mr. SENTER. Burleson, Texas.

Senator SYMMS. Where is that in Texas?

Mr. SENTER. That's 15 miles south of Fort Worth.

## STATEMENT OF DAVID SENTER, NATIONAL DIRECTOR, AMERICAN AGRICULTURE MOVEMENT, INC.

Mr. SENTER. Senator, we appreciate the opportunity to appear before this subcommittee today. We also very much appreciate your efforts in trying to deal with this issue that is becoming more and more important to producers across the country.

We found through the farm meetings we have all over the country, some 24 states already this year, that this is an issue that farmers would like to have addressed. Due to the drop in exports, depressed farm prices, these kinds of issues are becoming much more important. We find that all too often foreign policy has been dictating funding and programs regardless of the impact on U.S producers or also, just as important, the cost to our agricultural programs. Low interest, long-term payback, grants, all fund development and technology that in turn is competing directly with American producers and also disrupting some of our traditional markets.

Just this year the foreign aid appropriations for fiscal year 1986 is billions of dollars all going to a lot of different programs—the International Monetary Fund, the Export-Import Bank, and all kinds of agricultural related funding around the world.

We believe that the United States, through the P.L. 480 blended credits and all kinds of low interest direct aid programs, is in a position to help those needy nations with food. We also believe that we should continue to stand ready to help those in need and share the technology requested.

However, the United States should restrict the direct investment of U.S. funds to promote agricultural production in competition with U.S producers. We are increasing the cost of our commodity programs drastically at a time when budget deficits must be cut.

I want to just mention a few examples of funding that's in the current fiscal year budget. Thailand, for example, will get a million dollars in seed development grants, $2.6 million in irrigation development, and $1 million in agricultural technology transfer, and Thailand is the United States' main competition in rice production. In fiscal year 1986, $4 million is set aside for fertilizer development, $3.7 million was granted for spring wheat development around the world, $3 million for sorghum, $2.4 million for peanuts,

and all of these programs currently have acreage reduction programs because of overproduction.

The International Agriculture Research Center has $46 million in its fiscal year 1987 budget to "expand world food production." Agency for International Development has $5.5 million in grants to "increase world food production." And there's also the Bureau of Private Enterprise which has money to "establish satellite farming projects" worldwide.

I guess the bottom line, Senator, is that we wholeheartedly support your efforts to try to stop this investment that goes in direct competition with U.S. farmers and our organization stands ready to help in any way we can to make this become a reality.

Thank you very much.

[The prepared statement of Mr. Senter follows:]

## Prepared Statement of David Senter

I appreciate the opportunity to appear before this committee on behalf of the American Agriculture Movement, Inc. family farm members. All too often, foreign policy dictates programs and funding regardless of the impact on US producers and costs to our agriculture programs. Cheap interest, long term payback and grants fund the development and technology that, in turn, disrupts our traditional markets.

Under Foreign Aid Appropriations, $2.8 billion is available for development banks around the world. A second item is a multibillion item, the international monetary fund, and $13.1 billion for the export-import bank.

We believe the U.S. through the PL 480, and the many blended credits, low interest, and direct aid programs are helping those in need. We should continue to stand ready to feed those in need and share technology requested. However, we strongly believe, the U.S. should restrict the direct investment of U.S. funds to promote agriculture production of commodities (in surplus in the U.S.). By allowing this to happen, we are increasing the cost of our commodity program, at a time when budget deficits must be cut.

American farmers are concerned when faced with the following examples of grants that could be self defeating. Thailand, for example in FY 86, will get $1,000,000 in seed development grants, $2.6 million in irrigation development and $1,000,000 in agriculture technology transfers. Thailand is the U.S. main competition in rice production. In FY 86 $4 million is setaside for International Fertilizer Development, and in FY 85 and 86 $3.7 million was granted for spring-wheat Development; $3 million for sorghum, and $2.4 million for peanuts. All of these crops have acerage reduction programs because of over production in the U.S.

The International Agriculture Research Center has $46 million in its FY 87 budget to "expand world food production". Agency for International Development (AID) has $5.5 million in grants to "increase world food production". And the Bureau of Private Enterprise has money to "establish satelite farming projects".

These are just a few of the billions of dollars spent each year. We urge this Committee to prohibit money for foreign aid to be used to produce commodities in competition with U.S. farmers.

Senator SYMMS. Thank you very much, Mr. Senter. Mr. Nelsen, please proceed.

## STATEMENT OF PETER NELSEN, PRESIDENT, INTERNATIONAL TRADE COUNCIL

Mr. NELSEN. Senator Symms, we indeed appreciate the opportunity to be here. I feel like a skunk in church because I'm going to oppose what's being said so far—not the substance of it but the style of it.

I represent the International Trade Council, which is the trade association that has about 850 members, major companies and small companies that export agricultural commodities and art goods. We started out eleven years ago as the Agricultural Trade Council. We represented exclusively agricultural producers and eventually we ended up with a lot of members who were in agribusiness, so we changed to the International Trade Council with the Agricultural Trade Council being a division of it.

I, myself, was in the business of exporting livestock for five years. I had my Ph.D. studies in agricultural economics and I feel quite current on the subject at hand.

So it's with great trepidation that I find it necessary to say that the objective here is very important but the method is not the best one we could use.

We are part of the world economy. We are advised to follow our treaty obligations that we have signed onto, support of the World Bank, the IMF, the Inter-Continental Development Banks and so on.

The loans that were referred earlier today in the testimony are development loans. They are not production loans. The one percent loans are by IDA, the International Development Association, which is part of the World Bank, go mostly for infrastructure loans.

Now it is a little bit outrageous for the United States to demand that we should be the only ones in the world who have a right to export agricultural commodities. The fact of the matter is that we had the market to ourselves until our government started doing trade embargoes, and Brazil and other countries learned that they could also produce and serve the needs of the world market.

If we find it compelling to punish other countries for subsidizing their exports, we can do it by cutting our foreign aid to them. We have $4 billion in the economic foreign aid program of AID. We have $8 billion in the military aid program of AID. That would seem like a good place to cut it.

The CATO Institute here in Washington recently did a study on how AID has been mismanaged and wasted approximately $146 billion over the last 30 or so years, where in many cases they had a negative effect on development rather than a positive effect.

What the previous speakers have been saying is that they are not opposed to helping third world countries as long as they don't do it in their own sector. Many of these countries have—most of them in fact have bigger problems than we have economically. They have enormous unemployment. Agriculture to them is an in-

dustry that is labor intensive. In this country it is capital intensive. But to demand that they stop exporting is an impossible request.

What we need to do is have more effective export programs for our producers. Primarily, the government should once and for all pledge to stay out of the private sector economy.

I was at a briefing at the Commerce Department about four months ago where in the middle of a speech the Deputy Assistant Secretary said, "After all, exporting is a privilege. It's not a right." And some of us were rather shocked by that and he said afterwards, "Well, it's not in the Constitution that you have a right to export."

Well, this sort of mercantilist attitude that most countries have gotten away from over the last 100 years, the U.S. government still holds onto it. We wouldn't have lost the soybean market to Brazil if we hadn't had the trade embargo then. This is not a partisan thing because successive administrations have each done their own in the area of trade embargoes. You would never see Japan or Germany put a trade embargo on somebody. They stay out of other countries' local politics.

Let's for a moment look at the loans that are made. All the loans that are referred to here—IMF, World Bank, the Development Banks—are government to government loans. They do not directly benefit the individual farmer or help him individually export. If a country needs foreign exchange and it subsidizes its exports in order to be competitive on the world market, it is for either of two reasons: (1) To pay foreign debt, which is probably to a U.S. bank; or (2) to buy imports which to us would be exports.

They do not use foreign exchange in the domestic economy, so they can only use it in those two ways.

We do want them to live up to their debt obligations and we would like them to be trading partners with the United States. So if they subsidize an export, it's certainly not to do our consumers a favor but, rather, because they urgently need that foreign exchange.

So what we need to do is work out a system whereby there is free trade and whereby we recognize other people's problems and propose solutions to problems that fit into their needs as well. I thank you, Mr. Chairman.

[The prepared statement of Mr. Nelsen follows:]

PREPARED STATEMENT OF PETER NELSEN

Mr. Chairman and Members of the Committee:

I am Dr. Peter Nelsen, President of the International Trade Council (ITC). It is indeed an honor to be invited to speak before this Committee on the subject of U.S. agricultural exports, their export funding and their place in the world economy.

The ITC was founded in 1975 as the Agricultural Trade Council. It represented producers and exporters of agricultural commodities of which I was one.

My company exported livestock, meat and farm equipment. My doctoral studies were in agricultural economics and foreign trade policy.

In 1978, the Agricultural Trade Council was reincorporated as the International Trade Council (ITC) since many of our members are in agribusiness and the related industries. We kept the Agricultural Trade Council (ATC) as a division of ITC since we are known here and overseas as ATC, thereby reflecting our continuing work in the area of agricultural trade.

We submit this detailed background as substantiation for our claim that no association or individual could be more concerned about the problems of the American farmer than we are. It is, therefore, very difficult to go on record opposing the proposed Bills H 1810, etc. They are obviously well intended to serve the farmer constitutencies which are experiencing a very difficult period.

If Congress feels compelled to punish other countries, as noted in the Bill, who export some of the same commodities that the U.S. also exports in a glutted world market in order to earn hard currencies, and if their economies are so stressed that they feel compelled to subsidize their exports just like the U.S. does, then we ought to respect their sovereignty and let them solve their problems as best they can.

The United States is by treaties and accords obligated to support certain international institutions mentioned in the proposed legislation, such as the World Bank, the Regional Development Banks, etc. These institutions serve a vital function in the international economy -- to the benefit of both the industrialized countries and the Less Developed Countries (LDC's). In fact, it is safe to say that without these institutions the "Western World" would have very few trading partners in the LDC's.

If a LDC subsidizes its agricultural exports, it is not to upset another country, but probably because they desperately need foreign exchange (hard currencies). Foreign exchange can not be used in their domestic economies. They can only be used to either pay off foreign debt or purchase imports (both possibly with U.S. organizations).

If the U.S. Government insists on punishing the foreign governments rather than disavowing our treaty obligations to support the international institutions mentioned in the proposed bills, we suggest that they be rewritten so that we cut our foreign aid to the respective countries.

The $4 billion economic aid budget this year together with the $146 billion in previous economic foreign aid has according to a current CATO Institute study been largely wasted and in many cases caused more damage than good in fostering economic development. A copy of that study will be submitted if the Committee so wishes.

Even better than cutting the U.S. economic aid would be to cut the military aid ($8 billion in FY '84) of countries who would subsidize their exports. These countries would then have to help their private economies grow so that they can collect taxes with which to pay their military hardware.

The U.S. has been labeled as an unreliable trading partner and the U.S. is loosing its share of world exports because of continuing intervention by both the Legislative and Executive branches of our Government in the private sector economy which is in fact part of the world economy -- even though many in both industry and government have not accepted that fact.

As with other subject areas we can either lead or follow, or stand on the side lines and say that we won't play because we don't like the rules.

Leadership would include helping our producers be competitive on the world market, i.e., eliminating trade barriers providing competitive financing for export production and eliminating taxes that our overseas competitors are not subject to, and changing the mercantilist attitude of the U.S. Government.

At a recent briefing at the U.S. Department of Commerce, I was shocked to hear an Assistant Deputy Secretary of Commerce state in the middle of his speech, "....after all exporting is a privilege, not a right." Upon questioning him, he stated, "There is no right to exporting stated in the Constitution."

I researched the subject and he was right; cases in constitutional law on the subject of the individuals right to export generally were decided in favor of the state.

The rest of the industrialized world has long ago changed from mercantilism to the private or corporate individuals right and initiative to export to be the engine of growth for their economies.

We, therefore, urge that, if our Government exists to serve the people instead of the converse, then strong legislation is needed to affirm the individuals right to export and the Government pledge to support that effort -- then our farm surplus will be sold and our Ag-sector, along with each other sector, will prosper.

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Senator SYMMS. Thank you very much. I suppose it's always good for us to have a contrarian point of view to check us on just exactly what it is we're trying to accomplish. So I appreciate your testimony.

But as an economist and educated in agricultural economics, under the theory of an ideal world where we had open borders and free trade, doesn't that economic theory of trade say that the countries should export products where they have a comparative advantage in producing? Isn't that generally what people would accept?

Mr. NELSEN. That's the ideal way.

Senator SYMMS. Well, are there any of these less developed counties that have an advantage and are more efficient than U.S. farmers and the U.S. transportation network and the Mississippi Basin and so forth?

Mr. NELSEN. No, there aren't. But they're desperate. They can't produce automobiles or airplanes. They have to produce and export something that they can earn money with. They would like to produce higher grade or high tech items, but most of them haven't got the infrastructure or the educated labor force to do that.

Senator SYMMS. Well, I guess the point of my question is, you know, I've seen some of the lands in Brazil that are just magnificent, millions and millions of acres of land literally, of land that looks as though it could be farmed if you fly across it. But there are no railroads and little dirt roads are the only means of transportation in and out. I can't quite see why a U.S. farmer should be expected to pay taxes to build the infrastructure in Brazil to provide for the competition so that if they had the transportation system they could compete against us and they might have a comparative advantage. What's fair about that?

Mr. NELSEN. The per capita income of those farmers in Brazil is probably $400 a year, and if we build roads not just to grow soybeans but to produce all kinds of things, and their per capita income goes up to $800 or $1,000 a year, they can then afford to buy textbooks and Coca-Cola and machines and whatever else they might need and they then become a trading partner of the United States instead of just being a recipient of P.L. 480 grain and low-interest loans.

Those low-interest loans are an emergency measure to help the ones that are down and out and have no other way of becoming part of the world economy.

Senator SYMMS. So then, in your view, what you're saying is that in the long run we would be better off to leave the World Bank and the other international lending institutions to continue to do business the way they're doing it?

Mr. NELSEN. We have a vote there. We're not saying to just give them money and forget about the money. But to cut our treaty obligations to support these institutions is regarded very negatively in the world political scene.

Senator SYMMS. What about the point that if we—I lost the question that I was going to ask you.

Mr. NELSEN. Let me just mention one thing and it might come back to you. As an example, we reach out in the CBI, the Caribbean Basin Initiative. We want those countries to become part of the world economy. Then we exclude sugar as an agricultural commod-

ity, textiles and rum, which are the three things that they are good at doing. It would be like the rest of the world telling us you can export everything to us except agriculture, logs and airplanes, which happen to be the only three commodities where the United States is in a positive trade balance.

Senator SYMMS. Well, let me ask you this question. What about the austerity programs that the international lending institutions impose on these countries that block out U.S. exports that we could sell to them? We don't allow them to do that. We impose on them that they have to be austere, they have to cut off their purchases from the U.S. agriculture, for example, and try to self-finance it.

Mr. NELSEN. Because they have an unlimited propensity to want modern day conveniences, just like our farmers who fell for the need for having a 200 horsepower tractor and two harvest silos and enormous debt. They're the ones that went broke. They're the ones that you see in foreclosure sales, not the ones that are conservative and try to get by with something less glamorous.

What the IMF does in imposing these limitations is to keep them within a budget. They look at what their production capability is, they look at their debt, they look at their probability of earning enough to service that debt, and they try to keep them within their budget as an accountant or as an auditor would in a corporation, advising them in a very hard way in some cases—if you want our support, then you must stay within these guidelines.

Senator SYMMS. If the per capita earnings of a Brazilian is $400 a year and they increase economic activity—or let's say they generate income in an effort to raise it to $800 a year, as you suggest, is it possible with the debt burden that their governments have run up that the Brazilian farmer will get the increased standard of living, or will all that money just go in interest payments on the loans that they have already incurred?

Mr. NELSEN. It has to increase the revenue from farming to the farmer. The exact percentage I'm not able to give you an answer to. If you'd like me to research it I could.

Senator SYMMS. But they are so far in debt and they owe so much money to our large banks in the United States, I wonder if the Brazilian worker or the poor farmer in Brazil will ever see the light of day or if the money will all go to interest. That's the question.

Mr. NELSEN. Probably not, because most third world countries look after the urban constituency rather than the rural constituency. Every third world country controls its agricultural production and pricing.

I just got back from two days in the Dominican Republic. They sell farm commodities at above production costs but the farmer gets paid less than production costs, and the government keeps the difference.

In other countries it's the other way around. In Egypt they subsidize bread to such an extent that the farmers can buy bread in the store and feed it to the livestock cheaper than they can import feed grains from the United States.

These are political corners that the officials have gotton themselves into in some cases. In other cases, it's pure methods of cor-

ruption of collecting money for their own pockets. It is tragic but it's like that in every country.

Senator SYMMS. Well, thank you very much. I appreciate your testimony.

Mr. NELSEN. Thank you, Senator.

Senator SYMMS. I don't think I completely agree with everything you've said, but you've certainly given this committee some things to think about.

Mr. NELSEN. I hope we can both understand that our concern is for the benefit of the U.S. farmer. I was a farmer myself until six years ago in Frederick County, Maryland, and what we are trying to do is find answers to the problems and we thank you for the opportunity to be here.

Senator SYMMS. Thank you very much.

Mr. Senter, do you have anything else you want to add?

Mr. SENTER. Senator, I'd just like to make the point once again that we have $52 billion that we can spend on farm programs during three years. At the current spending level, in a year and a half we will have spent the $52 billion and under Gramm-Rudman we will have a very difficult time securing any more money to run agricultural programs.

When you increase production of our competitors around the world you increase the cost of our farm programs and at a time when budget deficits are tremendous here in this country we have to look very seriously at our priorities.

I just heard about the $400 per capita income of farmers in Brazil. Last year in Oklahoma, $18 per farm was the net farm income and we have to look at priorities and we have to protect our own infrastructure and, as you're well aware of, we have serious problems here of our own and I think we have to get the priorities straight. Thank you, Senator.

Senator SYMMS. Thank you very much, both of you.

The next witness will be Mr. Alan Reynolds, economist at Polyconomics, Inc.; and Mr. Timothy Hallinan, former World Bank economist.

We welcome both of you gentlemen to the subcommittee. Mr. Reynolds, we're happy to have you here and we will hear from you first and then we will hear from Mr. Hallinan and then we will have some questions for both of you. I hope you can both make your statements within five minutes.

Mr. REYNOLDS. Five minutes?

Senator SYMMS. Well, if you can.

Mr. REYNOLDS. I was going to read it and I think it will take about ten minutes.

## STATEMENT OF ALAN REYNOLDS, VICE PRESIDENT AND CHIEF ECONOMIST, POLYCONOMICS, INC.

Mr. REYNOLDS. The Foreign Agricultural Investment Reform Act addresses the depression of U.S. agriculture, the decline in farm exports, and the lending practices of multilateral banks. These problems are somewhat related to each other, and also to trade wars, yet each issue is much larger than anything touched by this legislation.

Multilateral banks do seem too inclined to promote a "quick fix" in terms of hard currency exports, including agricultural products, and also to condone import restrictions in developing countries. Multilateral banks also tend to discourage small scale private entrepreneurial ventures, in favor of unprofitable socialized enterprises, due to the practice of lending to governments, which invest for political rather than economic gain. All multilateral lending, as well as most foreign aid and private lending, is too often linked to myopic "austerity" programs of the International Monetary Fund—programs that have repeatedly failed to produce anything by hyperinflation, protectionism, depression and revolution.

Taking a short-term, country-by-country perspective, the IMF adopts the banker's approach of creating a quick export surplus in each country to earn dollars to service debts. Typical conditions on IMF loans are to devalue the currency, eliminate trade deficits and budget deficits. But the whole world cannot run trade surpluses with itself; all countries cannot devalue their currencies against each other; and higher tax rates are self-defeating in distressed economies. Countries hostage to these IMF conditions find tariffs irresistible, since tariffs create the illusion of reducing both budget and trade deficits.

Repeated devaluations in countries already plagued by hyperinflation invariably provoke capital flight, and inflation accelerates. Lacking indexed tax systems, many of the developing countries soon find themselves with tax rates of 60 to 80 percent at incomes of $2,000 or less per year. Punitive tax rates drive any remaining production underground and result in still more capital outflow. More foreign loans are then needed to replace the lost domestic capital, and the interest payments on those loans turns trade surpluses into current account deficits.

The end result is rapid collapse of any but the most basic industries, such as raw materials and basic textiles. These products must be dumped for whatever the protectionist world market will bear in order to acquire dollars or yen to service foreign debts. With little to trade, depressed LDCs have no choice but to slash imports. U.S. exports to 21 debt-burdened developing countries dropped by 31.3 percent between 1980 and 1984.

The way out is almost the opposite of IMF conditions. Troubled economies need to peg their currencies to a hard currency, reduce tax rates and raise and index thresholds at which those rates apply, eliminate tariffs and import quotas, minimize capricious and corrupt government regulation, privatize nationalized industries that bleed the treasury, and secure property rights. The U.S. and international agencies it supports need to attach such constructive conditions to foreign loans, rather than continuing to underwrite and subsidize only destructive policies. The problem is not foreign abundance and success, but global scarcity, policy failure and poverty. "Developing countries" has become a euphemism for economic implosion.

### GLOBAL MONETARY DEFLATION

Personal income of U.S. farm proprietors fell by 61.5 percent from December 1985 to March 1986, which is simply too big and too

sudden to explain by relatively small loans to develop foreign agriculture over a period of years. The main domestic farm problem is falling prices, not just export volume per se; and that problem is worldwide, not merely a matter of the U.S. share of shrinking export markets. Total farm and nonfarm imports of the noncommunist world, outside the United States, fell 5 percent from 1981 to 1985. The U.S. could easily capture a larger percentage of the smaller world market if farmers were infinitely willing to lose money. But farmers would be better served if policy instead focused on why they are losing money on what they already sell, and why non-U.S. imports of both farm and nonfarm products have been so small.

Last year, U.S. agricultural exports fell 23.7 percent in dollars, but 14.8 percent in real terms. The difference represents price declines. At the end of April 1986, the Commodity Research Bureau index of prices of foodstuffs was 28.4 percent below the level of two years earlier; yet the same index for industrial commodities such as metals and textiles, but excluding oil, was also down by 23.8 percent. This suggests that farm prices are part of a broader problem, and the only thing all commodities have in common is money. Every price is a ratio of quantity to dollars, such as bushels of wheat or barrels of oil per dollar. The problem is not too many bushels and barrels, but too few dollars.

During every inflation in history, there were widespread reports of "shortages"; in every deflation in history, there were widespread reports of surpluses or "gluts". In reality, a general surplus of commodities can only mean a shortage of money or, equivalently, a real interest rate on cash that exceeds the return on real goods. An excess demand for money is always mirrored in falling prices.

During deflations, governments often adopt the theory that people would be better off with fewer goods, since that would supposedly force consumers to pay a higher price. This leads to killing chickens, pouring milk in rivers, plowing grain under, and restricting imports of goods that farmers buy. Prices do not rise in this situation, however, because the world's consumers could not afford to pay more for everything even before such legislated scarcity made them poorer. Instead, protectionism aggravates deflation by requiring worldwide distress sales in shrunken markets to pay bills.

When the real interest rate on cash is very high, the world liquidates goods and hoards cash. Valuable money produces cheap goods. Some decline in commodity prices was, of course, a necessary cost of reversing the inflationary Federal Reserve policy of 1977–80, when the interest rate on Fed funds was deliberately kept below the inflation rate in producer prices. But that "real interest rate" has been well above 7 percent since 1981 and it still is, and that is now overkill in the war against inflation. Commodity prices will continue to fall as long as this monetary policy continues, and commodity producers will continue to plead for protection. What they need is protection from the world's central banks.

When commodity prices fall, loans based on commodities or related collateral, such as farm land, are faced with default. If a commodity price falls in half, the producer has to sell twice as much merely to meet the principal on his loan, so the real interest rate

more than doubles. In 1985, 120 banks failed, with assets of $9.1 billion, and 62 were farm banks. This year we will do worse.

Commodity prices remain depressed because the dollar has not declined and the Fed has not eased. Instead, Japan, Germany, France and the U.K. have pushed their own real interest rates to stratospheric levels (above 13 percent in Japan), which is part of the explanation for the falling prices and falling industrial production currently threatening even Japan. When prices fall below costs, production shrinks and so do the imports that went into that production. The world needs more output, not less, because growing economies import more, and world exports cannot excess world imports.

Asia is by far the biggest market for U.S. farm products, and a huge market for oil. It doesn't matter whether Asian or Latin American economies buy cotton, hides, soybeans, lumber or petroleum from the U.S. farm belt and oil patch. The effect is most obvious in the case of cotton, where U.S. exports in March were down 70 percent from last year. Asian producers of cotton textiles do not need cotton because the U.S. is restricting imports of cotton fabric, and textile producing countries have no way to earn the dollars to both pay for the cotton and pay interest on debts to U.S. lenders.

Major losses of U.S. export markets already include the developing countries, OPEC, the Eastern European bloc, and some contracting economies like Israel and Greece—all of which cannot afford to import as many U.S. goods because of heavy debts and poor economic performance. In many cases, the poor performance is largely related to the general deflation of world commodity prices. Yet these countries have also embraced suicidal domestic policies that were endorsed and even demanded by multilateral banks, particularly the IMF.

To conclude, the following is a broad outline of policies that would help the U.S. farmer, though that is a small part of their worldwide benefit:

(1) Repeal the provision of the Humphrey Hawkins Act that requires the Federal Reserve to report on various measures of money, and replace it with a requirement that the Fed report on how its actions have been affecting prices, and how they are expected to affect prices in the future. The Fed's mandate must be to stabilize the dollar's value in terms of something—commodity prices, gold, or at least producer prices.

(2) Enact tax reform, partly to avoid "tax farming" and other distortions and disincentives. The main difficulty with the Senate Finance Committee tax proposal is the half-year reduction of tax rates for 1987, which would impose a temporary marginal tax rate of at least 38.5 percent at modest incomes, even on capital gains.

(3) Encourage "Baker Plan" conditions on all U.S.-supported multilateral loans, as well as AID grants. That is, stop underwriting policies that promote hyperinflation and depression among third world trading partners, who are both a source of low-cost inputs and a market for U.S. goods and services.

Thank you, Mr. Chairman.

Senator SYMMS. Thank you very much for your excellent statement. Mr. Hallinan, please proceed.

## STATEMENT OF TIMOTHY HALLINAN, FORMER WORLD BANK ECONOMIST

Mr. HALLINAN. Senator, I would like to read an abbreviated version of the testimony that I think you have. It will take me about nine or ten minutes, if that's agreeable.

Senator SYMMS. That will be fine.

Mr. HALLINAN. First off, Senator, I would like to thank you for your invitation to testify on the subjects which now face us. As one who was born in a foreign country I regard it as a particular honor and one which I very deeply appreciate.

For most of my professional life I have been addressing the problems of the developing countries and the institutions which were originally designed to help them.

My professional interest in economic development in international organizations began at Oxford University, and continued in the Far East as an official of the Agency for International Development, and then at the Rand Corporation in Santa Monica. From there I joined the staff of the World Bank, where once again I was able, more or less, to practice what I preached.

The present is a very good time to be examining these issues. The World Bank is once again scheduled to have a new president and it is very appropriate that the Congress review the U.S. role in that institution to see whether or not it is meeting the objectives for which it was originally designed.

The FAIR bill which I heartily endorse underlines the urgency of this situation.

In my testimony this morning, I would like to place these issues in their larger context. I do this because current policies of the multinational lending institutions damage not only the interests of the U.S. farmers, but other U.S. workers as well in textiles, in pharmaceuticals, in chemicals, and many other industries.

I do this also because our international financial institutions are now so distortive in their impact on the economies of so many countries, they are beginning to threaten some of our larger, long-term foreign policy objectives.

We should note, first of all, that there has been a fairly massive failure of many developing countries to achieve the overall progress which ten or fifteen years ago we had every reason to expect. Almost all the countries of Sub-Saharan Africa, the Caribbean, and Central and South America have turned in poor performances. Turkey, Pakistan, India and the Philippines have all been disappointing.

Clearly, both the countries themselves and the international institutions allegedly assisting them, are doing something wrong.

I would like to offer some very specific proposals for changes in the modus operandi of the most important of these two institutions, the World Bank and the IMF, and changes in their macroeconomic policies. I'd like to go on to very briefly identify some of the operational changes in these institutions which would make these policy changes easier to implement and much more likely to stick.

Probably the most important single policy change we need concerns exchange rates.

Suppose a businessman in a developing country has assets worth, say, $100,000 in local currency. If, as is almost sure the case, his currency is overvalued in terms of its real purchasing power, his assets would be worth far more—maybe $150,000, if he can transfer those assets into dollars.

This situation has two important effects worldwide. First, it means that the government—usually the central bank—has to step in to "ration" the allocation of foreign exchange among the parties who want it, and as such allocations are immensely valuable to those who receive them, it becomes standard practice for the recipients to pay whoever controls or facilitates such foreign exchange allocations a significant share of this "unearned" profit.

I know of very, very few developing countries with sufficient institutional integrity to withstand the temptations which are inherent in this system.

Secondly, it stimulates enormously the demand for loans denominated in foreign currencies. Much has been said both in Congress and the media about the alleged incompetence of our larger banks in lending overseas unwisely. Not nearly enough has been said about the propensity of developing countries to borrow, which was then, and still is, built into the system.

Timely devaluations are much more easily recommended than put into effect. As one who has been deeply involved in many of these exchange rate adjustments, I will readily testify as to how difficult they are.

The result is almost always a process of quite incredible spasticity. Instead of a smoothly working, self-adjusting system, we have a system characterized by the protracted buildup of distortions, followed by sudden, sharp corrective shocks.

It is not a system which anyone would conceivably design.

Why not then opt for floating exchange rates? In the IMF view, floating exchange rates for third world countries are impractical because the international markets for their respective currencies are too small to prevent their being rigged.

I believe this position is wrong. We are not really faced with an "either/or" choice between fixed and freely floating exchange rates. There is a great variety of "floating systems" to choose from: from a totally unregulated float with little or not central bank intervention (e.g., the Hong Kong dollar) to floats so dirty that the currency in question is usually under water.

There are joint floats, there are cross-floats, and a great variety of monitoring systems which the IMF could establish to protect a currency from a concerted effort to manipulate its level.

In fact, there are many ways by which a phased-in deregulation of controls on the private sector's purchase and sale of foreign exchange could be put into place once we have accepted this objective.

I see no reason why we should not move ahead on this forthwith.

Secondly, this policy should be supported by a corresponding deregulation of borrowing countires' domestic financial institutions, including and especially interest rates.

Fixed interest rates, which invariably mean low rates, discourage internal capital accumulation.

They also bring in their wake allocative systems similar to the ones brought into play in the foreign exchange market. Clearly, if a businessman expecting a return on his investment of maybe 30 or 40 percent can borrow funds at 5 or 6 percent, such funds as are available will be rationed by non-market procedures.

This too, leads to corruption. But it also leads to large sums of money flowing into "informal"—i.e., non-institutional—channels, and reduces the funds available for productive investment.

It starves developing countries of their small business class, the class from which big businesses should be emerging.

We should, of course, go further. Clearly, state-sponsored monopolies other than those which have a legitimate basis in economics or history (in telecommunications and power, for instance) are road blocks in the developmental process.

And, as they often drive up the prices of important staples, I might add that they are usually enormously unpopular and often their unpopularity fuels other discontents (as has happened frequently, in Iran, in Haiti, and in the Philippines). They are a source of instability.

The World Bank should insist that, as a condition of its aid, borrowing countries take appropriate steps to dismantle such unnecessary impediments to the developmental process.

Clearly, in the field of deregulation, the United States should speak with the authority of its own experience which by and large has been enormously successful.

Third, once these objectives are in place as official policy, there should be a rapid phase-down of loans for projects which cease to provide sufficient rates of return in an "open economy" environment.

This would have two effects. It would quickly discourage the production of goods, particularly agricultural products, for which a country has no comparative advantage. The U.S. farmer would undoubtedly benefit from this.

It would also encourage the production of goods which a country can produce efficiently.

Fourth, we need far greater participation in World Bank projects from the private sector. The Bank staff legitimately takes great pride in its development of the analytical procedures for assessing the value of specific projects, and eliminating those that give inadequate rates of return on invested capital. Why is it, then, that the private sector finds such projects unattractive?

The availability of co-financing from private sources should become an increasingly important criterion in making the decision as to whether or not a project should be approved.

In this connection, I would like to add that the functions of the International Finance Corporation, the IFC, should be transferred back to the Bank.

Fifth, we need more emphasis on what I choose to call (the Bank does not) "poverty-related" projects. Recommendations for the freeing up of mangled, if not strangled, markets often provoke fears that those at the very bottom on the social ladder would suffer from the changes that freer markets would bring.

This perception is both widespread and important, whether or not it is justified. I would like to address it, sir, if I may, head on.

The Bank has accumulated over time an extraordinary range of expertise in this area, particularly in education, health, nutrition and urban services.

Unfortunately, these projects have been dropped into the Bank's overall lending programs, where they are subject to management criteria which have distorted their purpose, as in the case of "Site and Services" projects, and/or unduly shrunk their scale, as in the case of many education projects.

Some of these concepts have enormous potential. The "Site and Services" concept is particularly important, in light of the increasing slums of the third world's primate cities. Indeed, it is one of the great conceptual breakthroughs which the Bank has to its credit.

I suggest that these projects be placed in a different organizational context and receive far greater emphasis.

We owe this to the poorest members of member countries' populations. We also owe it to ourselves. Rightly managed, this type of project can help enhance a country's political stability.

Let us turn very quickly to some of the changes which the Bank and the Fund should make in their modus operandi.

First, the days of ever-swelling loan portfolios should be brought quickly to a close.

The practice of setting "lending targets" on a country-by-country basis, which began in the McNamara period, should be ended.

Ceilings, getting lower and lower over time, should be set for all new lending. The notion—again, a legacy of the McNamara era—that the Bank commands unlimited (and costless) resources which it can allocate at will encourages attitudes to the allocation of scarce resources which, if the Bank detected them in a borrowing country's institutions, it would quickly criticize.

Secondly, we need to restore a greater measure of selectivity in its lending activities. Ceilings should be put on the size of the professional staff of the World Bank, and these ceilings lowered on a systematic basis over time.

Third, we now have an extraordinary inefficient and expensive overlapping of functions between different institutions. Clearly, over time many of the functions now performed by the World Bank would be more appropriately performed by the regional development banks which should, over time, became stronger.

But the real trouble now lies in the overlapping roles of the IMF and the Bank. Short term loans, basically for balance of payments purposes, were originally exclusively the province of the Fund; the Bank has no business making loans ("Structural Adjustment Loans") for exactly the same purpose.

The core roles of the two institutions should be given back their former clarity.

Fourth, we need much clearer guidelines for the phasing out of new project loans for countries which have passed beyond the critical "poverty-line" level. We also need a stepped-up program for "graduating" the more successful of the developing countries from borrower to lender status.

Fifth, all the multinational institutions—the Fund, the Bank and the regional development banks—should make their data more widely available in a prompt and timely basis.

And lastly, we should have prompt and immediate exclusion from the World Bank, the IMF and the regional development banks of all countries with centrally planned (non-market) economies.

It used to be thought that membership of the Fund and the Bank (the two go together) would allow Soviet-bloc countries greater leeway in its dealings with the Soviet Union and greater opportunity to expand their "private enterprise" sectors.

This supposition is fiction. Given the political systems of communist regimes, Bank and/or Fund loans give those two institutions no leverage whatsoever for the attainment of any larger "liberalization" objectives.

More important, they reduce the amount of resources available for other countries which could use—and surely should use—those resources more effectively, to everyone's advantage.

Let me add parenthetically if I may, these are two—the Bank and the Fund—large monolithic institutions. Seen from outside, it is easy to believe that their doctrine never changes. In fact, there is increasing body of criticism within both of these institutions that would welcome these reforms we are discussing.

Thank you, Senator, very much indeed.

[The prepared statement of Mr. Hallinan follows:]

## Prepared Statement of Timothy Hallinan

First off, I would like to thank the members of this Committee for their invitation to testify on the subjects which now face us. As one who was born and raised in a foreign country, I regard it as a particular honor, and one which I deeply appreciate.

For most of my professional life I been addressing the problems of the developing countries and the institutions which were originally designed to help them.

My professional interest in economic development and international organizations began at Oxford University, and continued in the Far East as an official of the Agency for International Development, and then at the RAND Corporation in Santa Monica. From there I joined the staff of the World Bank, where once again I was able, more or less, to practice what I preached.

The present is a very good time to be examining these issues. The World Bank is once again scheduled to have a new President, and it is very appropriate that the Congress review the US role in that institution to see whether or not it is meeting the objectives for which it was originally designed.

The important bill now proposed, S 1810, underlines the urgency.

In my testimony this morning, I would like to place these issues in their larger context. I do this because current policies damage not only the interests of US farmers, but other US workers as well (in textiles, pharmaceuticals, chemicals and many other industries).

I do this also because our international financial institutions are now so distortive in their impact on the economies of so many countries, they are beginning to threaten some of our larger, long-term foreign policy objectives.

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We should note, first of all, there has been a fairly massive failure of many developing countries to achieve the over-all progress which ten or fifteen years ago we had every reason to expect. Almost all the countries of Sub-Saharan Africa, the Caribbean, and Central and South America have turned in poor performances: Turkey, Pakistan, India and the Philippines have all been disappointing.

Clearly, both the countries themselves and the international institutions allegedly assisting them, are doing something wrong.

The central question is - what?

Because the World Bank lends primarily to "parastatals", the recent expansion of the World Bank's lending has meant, inevitably, the spread of these parastatals across most, if not all, of the important "peaks" of the borrowing countries' private sectors.

These parastatals are often extremely inefficient: swollen payrolls are an almost universal failing.

But in any competition for scarce resources - imports, for instance, or bank loans, or favorable freight rates - they have the inside track; and over time they tend to squeeze out their private sector competiton.

In other words, the World Bank's lending tends to tip the scales very hard against the interests of the private sector.

This is a relatively new development, dating from the 1960s.

In fact, in some developing countries sectors which played an important role in the development of rural America (like poultry farming) have been surgically removed as part of the developmental process.

We are asking these countries to climb up the ladder of development while we saw away the rungs.

Second, and more fundamentally, we have allowed - and even encouraged - most developing countries' governments to increase the points at which they intervene in the economy.

Such interventions have a long, long history; in Western Europe, back to the Middle Ages. But every point of intervention (usually in the form of state guaranteed monopolies) represents a possible source of corruption; and it cannot be to our credit that when the lid blows off, as it did in Iran, Haiti and the Philippines, and in a somewhat different way in Mexico, we are suprised to find the system so corrupt at the top.

This point is crucial. It is not that the Bank (as it freely admits) is periodically flubbing its mission by making bad investment decisions. It is that its current "modus operandi" is now actively getting in the way of the developmental process.

All but a handful of developing countries are in fact "losing ground". What should we be doing?

I would like to offer some very specific proposals for changes in the Bank's and Fund's over-all, macro-economic, policies, and equally specific proposals for changes in the internal operations of these two institutions. These operational changes in turn would make the policy changes much easier to implement, and much more likely to "stick".

1. Exchange Rates

Probably the most important single policy change we need concerns exchange rates.

Suppose a businessman in a developing country has assets worth, say, $100,000 in local currency. If, as is almost surely the case, his currency is over-valued in terms of its real purchasing power, his assets would be worth far more - maybe $150,000 - if he can transfer those assets into dollars.

This situation has two important effects. First, it means that the Government - usually the Central Bank - has to step in to "ration" the allocation of foreign exchange among the parties who want it, and as such allocations are immensely

valuable to those who receive them, it becomes standard practice for the recipients to pay whoever controls or facilitates such FX allocations a significant share of this "unearned" profit.

I know of very, very few developing countries with sufficient institutional integrity to withstand the temptations which are inherent in this system.

Secondly, it stimulates enormously the demand for loans denominated in foreign currencies. Much has been said both in Congress and the media about the alleged incompetance of our larger banks in lending overseas unwisely. Not enough has been said about the propensity of developing countries to borrow, which was then - and still is - built into the system.

Timely devaluations are much more easily recommended than put into effect. As one who has been deeply involved in many of these exchange rate adjustments, I will readily testify as to how difficult they are.

The result is almost always a process of quite incredible spasticity. Instead of a smoothly working, self-adjusting system, we have a system characterized by the protracted build-up of distortions, followed by sudden, sharp corrective shocks.

It is not a system anyone would conceivably design.

It has four consequences. One is that the developing country's exports get progressively priced out of foreign markets.

The second is that as imports become progressively cheaper, domestic production of both industrial and agricultural products decline.

The third is that capital flight - or the purchase of assets abroad - becomes a very sensible strategy for those who can adopt it. We have as yet only grossly inadequate data on the scale and source countries of capital flight. But we have enough to know that in many countries it often takes place on a scale equal or greater than the inflow of foreign assistance.

But the fourth is the most important - and little noted in the professional literature. The system breeds political corruption of a particularly virulent nature.

Why not then opt for floating exchange rates? In the IMF view, floating exchange rates for Third World countries are impractical because the international markets for their respective currencies are too small to prevent their being rigged.

I believe this position is wrong. We are not really faced with an "either/or" choice between fixed rates and freely floating rates. There is a great variety of "floating systems" to choose from: from a totally unregulated float with little or no central bank intervention (eg. the Hong Kong dollar) to floats so dirty that the currency in question is usually under water.

There are joint floats, and cross-floats, and a great variety of monitoring systems which the IMF could establish to protect a currency from a concerted effort to manipulate its level.

In fact there are many ways by which a phased-in deregulation of controls on the private sector's purchase and sale of foreign exchange could be put into place, once we have accepted this objective.

I see no reason why we should not move ahead on this forthwith.

2. Financial Deregulation

This policy should be supported by a corresponding deregulation of borrowing countries' domestic financial institutions, including interest rates.

Fixed interest rates - which invariably mean low rates - discourage internal capital accumulation.

They also bring in their wake allocative systems similar to the ones brought into play in the foreign exchange market. Clearly if a businessman expecting a return on his investment of maybe 30 or 40% can borrow funds at 5 or 6%, such funds as are available will be rationed by non-market procedures.

This, too, leads to corruption. But it also leads to large sums of money flowing into "informal" (i.e. non-institutional) channels, and reduces the funds available for productive investment.

It starves developing countries of their small business class - the class from which big businesses should be emerging.

We should also go further. Clearly state-sponsored monopolies other than those which have a legitimate basis in economics or history (in telecommunications and power, for instance) are road blocks in the developmental process.

And, as they are often drive up the prices of important staples, I might add that they are usually enormously unpopular, and often their unpopularity fuels other discontents (as has happened frequently: in Iran, in Haiti and in the Philippines). They are a source of instability.

The World Bank should insist that, as a condition of its aid, borrowing countries take appropriate steps to dismantle such unnecessary impediments to the developmental process.

Clearly in the field of deregulation, the United States should speak with the authority of its own experience, which by and large has been enormously successful.

3. Changing Portfolio Mixes

Third, once these objectives are in place as official policy, there should be a rapid phase-down of loans for projects which cease to provide sufficient rates of return in an "open economy" environment.

This would have two effects. It would quickly discourage the production of goods - particularly agricultural products - for which a country has no comparative advantage.

It would also encourage the production of goods which a country can produce efficiently.

4. Increased Participation of Private Capital

Fourth, we need far greater participation in World Bank projects from the private sector. The Bank staff legitimately takes great pride in its development of the analytical procedures for assessing the value of specific projects, and eliminating those that give inadequate rates of return on invested capital. Why is it, then, that the private sector finds such projects unattractive?

The availability of co-financing from private sources should become an increasingly important criterion in making the decision as to whether or not a project should be approved.

In this connection, I would like to add that the functions of the International Finance Corporation (the "IFC") should be transferred back to the Bank.

5. "Poverty-related" Projects

Fifth, we need more emphasis on what I choose to call (the Bank does not) "poverty-related" projects. Recommendations for the freeing up of mangled, if not strangled, markets often provoke fears that those at the very bottom on the social ladder would suffer from the changes that freer markets would bring.

The perception is both widespread and important, whether or not it is justified. I would like to address it, if I may Sir, head on.

The Bank has accumulated over time an extraordinary range of expertise in this area, particularly in education, health, nutrition and urban services.

Unfortunately, these projects have been dropped into the Bank's over-all lending programs, where they are subject to management criteria which have distorted their purpose (in the case of "Site and Services" projects) and/or unduly shrunk their scale (in the case of many education projects).

Some of these concepts have enormous potential. The "Site and Services" concept is particularly important, in light of the increasing slums of the third world's primate cities. Indeed, it is one of the great conceptual break-throughs which the Bank has to its credit.

I suggest that these projects be placed in a different organizational context, and receive far greater emphasis.

We owe this to the poorest members of member countries' populations. We also owe it to ourselves. Rightly managed, this type of project can help enhance a country's political stability.

## INSTITUTIONAL CHANGES

Let us turn very quickly to some of the changes the Bank and Fund should make in their modus operandi.

6. Ceilings on New Lending

First, the days of ever-swelling loan portfolios should be brought quickly to a

close.

The practice of setting "lending targets" on a country-by-country basis, which began in the McNamara period, should be ended.

Ceilings, getting lower and lower over time, should be set for all new lending. The notion - again, a legacy of the McNamara era - that the Bank commands unlimited (and costless) resources which it can allocate at will encourages attitudes to the allocation of scarce resources which, if the Bank detected them in a borrowing country's institutions, it would quickly criticize.

7. Ceilings on Professional Staffs

Second, to restore a greater measure of selectivity in its lending activities, ceilings should be put on the size of the professional staff of the World Bank, and the ceilings lowered on a systematic basis over time.

More importantly, the Bank should address the problem Keynes identified at Bretton Woods: instead of building up a body of permanent officials, the Bank should recruit new staff for very specific terms (say, initially five years), the assumption being that after their tour staff members should return to their governments, or go back into the private sector.

8. The Re-focus of Functions

Third, we now have an extraordinary inefficient and expensive overlapping of functions between different institutions. Clearly, over time many of the functions now performed by the World Bank would be more appropriately performed by the regional development Banks, which should, over time, become stronger.

But the real trouble now lies in the overlapping roles of the IMF and the Bank. Short term loans, basically for balance of payments purposes, were originally the province of the Fund; the Bank has no business making loans ("Structural Adjustment Loans") for exactly the same purpose.

The core roles of the two institutions should be given back their former clarity.

9. Phasing-out Procedures

Fourth, we need much clearer guidelines for the phasing out of new project loans for countries which have passed beyond a critical "poverty-line" level. We also need a stepped-up program for "graduating" the more successful of the developing countries from borrower to lender status.

10. Greater access to data

Fifth, all the multilateral institutions - the Fund, the Bank and the regional Development Banks - should make their data more widely available in a prompt and timely basis.

11. Exclusion of Communist Countries

And lastly, we should have prompt and immediate exclusion from the World Bank, the IMF and the regional development banks of all countries with centrally

planned (non-market) economies.

It used to be thought that membership of the Fund and the Bank (the two go together) would allow Soviet-bloc countries greater leeway in its dealing with the Soviet Union, and greater opportunity to expand their "private enterprise" sectors.

This supposition is fiction. Given the political systems of Communist regimes, Bank and/or Fund loans give those two institutions no leverage whatsoever for the attainment of any larger "liberalization" objectives.

More important, they reduce the amount of resources available for other countries which could use - and surely should use - those resources more effectively, to everyone's advantage.

Thank you, Gentlemen, for giving me the honor of addressing you.

## SUMMARY

This testimony proposes that, in reformulating its policies vis a vis the major international financial institutions, and protecting its own interests from unfair foreign competition, the US Government should press for the following policy and institutional changes in the World Bank and the IMF.

The testimony recommends -

1. on exchange rate regimes: the establishment of modified floating (instead of fixed) exchange rates for all Third World borrowing countries, and a phased-in deregulation of controls on the private sector purchase and sale of foreign exchange.

2. on financial deregulation: a corresponding deregulation of Third World (borrowing) countries' domestic financial institutions, including interest rates.

3. on changing portfolio mixes: a rapid phase-down of World Bank loans for projects which cease to provide sufficient rates of return in an "open economy" environment, particularly in agriculture.

4. on increasing the role of private capital: a greatly expanded program for co-financing of new loans from domestic and/or foreign private-sector sources, with no ceilings to be applied on the private-sector borrowing; the functions of the the International Finance Corporation (a subsidiary organization of the World Bank Group) to be moved back to the Bank.

5. on "poverty-related" Projects: greater emphasis within the World Bank and the regional Development Banks on programs specifically targeted on the poorest parts of member countries' populations.

6. on lending ceilings: ceilings to be set for all new World Bank lending, with a gradual phase-out of new loans for countries which have passed beyond a critical "poverty-line" level.

7. on the staff size of the IMF and World Bank: ceilings to be established for the staff of the World Bank and the IMF, and reduced over time, with programs to facilitate increasing rotation of staff members to the private sector after five or ten year terms.

8. on the regional Development Banks: closer working relationships to be established between the World Bank and the IMF on one side and the regional development banks on the other, and overlapping functions between the Bank and the Fund allocated to one place or the other.

9. on phasing out lending to middle income countries: a stepped-up program for "graduating" the more successful of the developing countries from borrower status to lender status.

10. on greater access to data: all the multilateral institutions - the Fund, the Bank and the regional Development Banks - should make their data more widely available in a prompt and timely basis.

11. on Communist countries: the prompt and immediate exclusion from the World Bank, the IMF and the regional development banks of all countries with centrally planned (non-market) economies.

Senator SYMMS. Thank you both for most excellent statements that will contribute greatly to our record and what we want to establish with this hearing this morning. I thank you both.

Mr. Reynolds, you said that the Senate Finance Committee's tax bill would increase taxes because the new rates take effect in mid-1987 but repeal the capital gains in January.

Would you explain for the record how that works and what we should do to fix it?

Mr. REYNOLDS. My understanding is that the tax rate reduction is effective July 1987, which means that, for example, a 50 percent taxpayer would have a combined rate of 50 and 27, which works out to 38.5 for the tax year. Most of us are on a calender tax year. I am not absolutely certain and have been trying to find out whether this also applies to capital gains. If it does, then, of course, the capital gains rate for one year for that calendar tax year would rise from 20 to 38.5 and I think that would provide a rather strong incentive to liquidate assets toward the end of this year or in 1988, but certainly not to realize capital gains in 1987.

In a static sense, this might be a revenue gainer. In the real sense, it would be a revenue loser because no one in his right mind would utilize capital gains when the tax rate on them is temporarily much higher than at any other time.

Senator SYMMS. Assuming that it will cause a slow-down in the economy for the first six months period?

Mr. REYNOLDS. I think it is a risk for the whole year because activities won't be planned for the six-month period. They will be planned for the whole year. Even 38.5 is a lower rate than we have now, don't misunderstand me, but it's not a lower rate on capital gains. It's quite a bit higher.

Senator SYMMS. Mr. Hallinan, what would be the consequences on the lesser developed countries if the World Bank and the regional development banks simply insisted that the LDCs open their currency systems to the U.S. dollar for domestic use and then let the LDC farmers keep the dollars they earn? What would that impact be?

Mr. HALLINAN. I think the impact might be profound. I think there would be enormous resistance from the LDCs. I think the process of liberalization—many years took place between the articulation of, shall we say, the doctrine or ideology of deregulation at the University of Chicago and elsewhere and its implementation in the United States.

I think what we have to do is to begin pushing rather hard not only at the policy level but also at the practical level in this regard with the hopes that we will get progressively freer exchange rate movements amongst the LDCs over time. But we are talking of a five-year horizon now; we're not talking about anything probably more rapid than that.

Senator SYMMS. Well, did I understand that you favor floating exchange rates?

Mr. HALLINAN. Yes, I favor floating exchange rates under certain protective systems managed by the IMF. The size of the market for many of the LDCs currencies is very small and the IMF in stating these markets can be rigged is stating its defensive position. It is stating that, no, we have to have fixed exchange rates. Fixed ex-

change rates are, I think, a larger part—maybe 40 percent—of the troubles of the LDCs.

With a little pushing, a little encouragement, more doctrinal input from the United States, we could see this position reversed quite quickly. The IMF, I suspect, would be willing to move into a new regime quite rapidly and start putting it into effect.

Senator SYMMS. How may of the members would that be if we excluded all of those countries with a centrally planned economy? How many would that be?

Mr. HALLINAN. We would be talking of many countries, 60 or 70 countries. It's virtually the entire world now.

Senator SYMMS. Even a country like France, under Mitterrand, would almost have to be excluded?

Mr. HALLINAN. I'm thinking primarily of third world countries rather than the already developed countries of Western Europe, et cetera.

Senator SYMMS. I have had a difficult time getting responsive answers from the multinational banks. Do either of you want to comment on why that is?

Mr. HALLINAN. Yes.

Senator SYMMS. Nobody runs it or what is it?

Mr. HALLINAN. No; these are enormously self-defensive institutions. They are masters—to quote a famous British writer, C.B. Snow—of the strategy of the intricate defense. The initial line of defense is a total blackout on information. That, once penetrated, there are other defenses and other defenses beyond that.

These are not institutions which historically have asked to lend themselves to much outside scrutiny. That situation I think should be changed over time.

Senator SYMMS. Mr. Reynolds.

Mr. REYNOLDS. Well, I thoroughly agree and that's sort of standard bureaucratic behavior and I would extend the same argument to apply to our own Federal Reserve System which tends to be behaving much the same way.

Mr. HALLINAN. May I endorse that last statement?

Senator SYMMS. Doesn't this tend to make our multinational policies more difficult to change?

Mr. HALLINAN. Right.

Mr. REYNOLDS. Yes.

Senator SYMMS. Because they accept very little external influence.

Mr. HALLINAN. They do accept it over time. If consistently and vigorously pushed, they accept it. We have a new president coming into the World Bank. He can alter the positions of the Bank in exactly the same scale—hopefully in a different direction—than Mr. McNamara did when he became president in 1967.

Senator SYMMS. Well, how do the current policy makers at the World Bank and the IMF look on the plight of the American farmer, in your opinion?

Mr. HALLINAN. I think they don't. I think it has never been brought to their attention and the systemic errors of the international system or shortfalls of the international system they are not aware of to a sufficient degree. There is, in other words, a lot of spade work to be done in this respect.

Senator SYMMS. Mr. Reynolds.

Mr. REYNOLDS. Well, it just isn't their responsibility and therefore they are probably not paying much attention to it. That, again, is standard bureaucratic behavior.

To try to get a large institution to pay attention to something that isn't its job is going to be inherently difficult.

Senator SYMMS. Mr. Reynolds, you didn't quite say in your statement whether you were for or against the FAIR bill. Do you have any comments to make about that?

Mr. REYNOLDS. Yes. What I am trying to say in that is that I think that some of the premises of the bill are incorrect, notably that the problem is excess supply. That tends to be a chronic explanation for everything.

For example, the same thing could be said of oil. The fact that the Saudis are producing the same amount of oil. The fact that the Saudis are producing the same amount of oil as they did in 1983–84, four and a half million barrels a day, is not the reason the oil price declined so dramatically. Neither can we explain the dramatic decline of agricultural prices without reference to the fact that when we're saying prices we mean prices in dollars, and dollars is a matter of monetary policy. There is a kind of a zero sum——

Senator SYMMS. At what point do you think the Saudis will want to start pricing oil in some other currency?

Mr. REYNOLDS. Good question. It's not clear they really can or that they really want to or that they have the power to do that by themselves. They would have to get a lot of other countries to go along with it.

I would think if all of those conditions were fulfilled, they would be doing so now.

Mr. HALLINAN. I think they can price it in any currency they want. It's got to be paid for in dollars.

Mr. REYNOLDS. That's right.

Mr. HALLINAN. They can price it any way they want to.

Senator SYMMS. Well, with the dollar in a decline, it appears to me that they are getting less for their oil.

Mr. REYNOLDS. Well, they are buying it from other countries, for example, European countries, and their real purchasing power declined very, very dramatically after the E–5 agreement of September 22.

Another part of what my testimony is trying to say is that the dollar isn't in decline but those other currencies are appreciating so fast that they are experiencing rather rampant deflation, particularly in yen, even in consumer prices in most of the European countries but also particularly in producer prices.

In that situation we want to be very clear which currency is up and which currency is down. We need a reference point. My reference point is prices. It's very hard to say the dollar is weak when prices are falling in dollars.

Senator SYMMS. Well, thank you both very much for some excellent testimony which we appreciate having for our subcommittee record.

Congressman Craig is our next witness. He is not here yet, so I'm going to stand the subcommittee in recess for about five minutes to see if he's going to show up. But I would first ask unanimous con-

sent that his entire prepared statement be included in the record at this point as though he were here. The subcommittee will stand in recess for about a five-minute break and see if he is going to show up. And I might also announce that if we don't come back in, that we will be back in session at 2:00 p.m. this afternoon to continue this hearing under the chairmanship of Senator Jim Abdnor of South Dakota.

I now see that Congressman Craig has arrived so we will allow you two to be excused. We thank you very much for your excellent testimony.

Are you ready to testify, Congressman Craig? We welcome you to the hearing this morning. Do you have copies of your testimony?

Representative CRAIG. I do, Mr. Chairman.

Senator SYMMS. I appreciate you coming over. I know you are very busy this morning and although it's not too far in distance, sometimes it's difficult to get across the Hill. Thank you very much for being here.

**STATEMENT OF HON. LARRY E. CRAIG, A U.S. REPRESENTATIVE IN CONGRESS FROM THE FIRST CONGRESSIONAL DISTRICT OF THE STATE OF IDAHO**

Representative CRAIG. Thank you very much, Mr. Chairman. you're absolutely right. I always leave my office or seem to leave it five minutes after I should have. That's why we're running a little late this morning and I appreciate your understanding of that.

Senator SYMMS. I might mention for the benefit of the audience here that you are my congressman, as a matter of fact, and a darned good one.

Representative CRAIG. Thank you. That's kind, Steve.

I really do appreciate you holding these hearings on what I view as an extremely timely topic, and that's foreign agricultural investment reform.

Tomorrow, the House of Representatives that I work in will begin consideration of a budget proposal aimed at reaching a deficit of $137 billion for fiscal year 1987. Here, on the eve of the House debate on the budget resolution, Mr. Chairman, I'm going to offer up a little prayer for common sense—the kind of common sense that distinguishes between good investments and bad ones; the kind of common sense that knows when to intervene and when to leave well enough alone; the kind of common sense that keeps us from pulling the trigger when we're about to shoot ourselves in the foot.

It is particularly appropriate to be talking about foreign agricultural investment reform because it is just the kind of fiscal common sense that I'm asking for and that I think you're asking for and that you've stood for for a long time.

No sensible person would fight a flood by turning on a fire hose to hold back the water, but that is what we have been doing on the international market. We have farmers going bankrupt in a world awash with agricultural commodities, yet we pour millions of taxpayer dollars through the World Bank and others to add to the flood and develop new agricultural exporters.

For example, Argentina received multilateral farm credit of more than $100 million over the last five years for the expressed purpose of developing its export potential in grain and oilseed. As a result, it doubled its market share of wheat and wheat flour exports, becoming the world's fourth largest exporter of that commodity. During the same period, the U.S. share of world wheat and wheat flour exports fell from a high of 48 percent to less than 30 percent, according to USDA statistics.

This is by no means an isolated example. In 1983, Brazil got a loan of $400 million for agricultural sector development, at 11 percent over an 18-year period. Since then, Brazil's farm exports to the U.S. have increased 67 percent. The annual reports of the World Bank and other multilateral financing organizations show a $200 million loan to finance a credit program designed to boost exports in Brazil, $56 million to increase agricultural output for export from Chile, $80 million to expand exports of processed animal products from Hungary, $60 million to increase export incentives in the agriculture and livestock sectors of Uruguay, $35 million to increase vegetable production for export from Yugoslavia. The list goes on and on.

It isn't just foolhardy, Mr. Chairman. Well, it is that. More importantly, I think it's downright foolish to finance our competitors and in an increasingly competitive market.

Let me make clear that I do not object to international contributions aimed at encouraging agricultural production for domestic consumption. Investing in foreign agriculture so that a nation can help to feed its own people is a humane and a wise investment, and this country has always concluded that it would make those kinds of investments.

However, I do object to economic development projects that use our tax dollars, our farmers' tax dollars, to promote agricultural production for export purposes to compete directly against those who are paying the taxes to finance this kind of development.

It doesn't make good fiscal sense. It doesn't make good common sense. And I think that's true for two reasons. First, in view of world surpluses in most commodities, agricultural exporting is a poor economic development venture for the long term, and low-cost international financing leaves the new exporter with an enormous debt service burden, and he finds himself oftentimes in a cash flow situation where he must or the government must continually stimulate to increase production at ever lower costs to maintain the cash flow. These countries often find they must subsidize, as I have mentioned, tapping even more of the scarce dollars they should be spending on their own people for purposes of domestic services.

Second and more important, it doesn't make sense because it contradicts our efforts to ease the crisis in our farm sector. Congress has been searching for solutions by making shifts in our farm programs for the last good many years. For example, the 1985 Food Security Act lowers the market loan rate in order to make U.S. commodities more competitive in the world marketplace. Judging by past experience, we can expect our foreign competitors to respond by lowering their own prices even further—a response many can afford because of international agricultural financing policies which allow it to happen. If this comes to pass, the 1985 farm bill

will have, in essence, failed. There will be more surpluses, more farmers out of work, more communities disrupted. As you know, Steve, we had our first bank failure in Idaho this week as the result of farm problems in our state.

These foolish, counterproductive investments must be stopped.

I am pleased to be an original co-sponsor of the House version of FAIR, the Foreign Agricultural Investment Reform Act that you, Steve, have introduced—I in the House, of course, and you in the Senate. House Bill 3643 and Senate Bill 1810 are aimed at this fundamental problem in international lending policies.

These bills do not interfere with the funding going to needy countries which require help to feed themselves and their people. They merely discourage the international financing institutions we fund from subsidizing foreign competition in those agricultural commodities that are already in surplus on the world marketplaces. If an institution continues to support such programs over our objections, these bills provide that our funding level for the institution will be reduced accordingly.

Congress has been searching for ways to cut federal spending and improve our country's balance of trade. This is a good place to start. In fact, unless we curb the international financing practices that are flooding the agricultural marketplace, none of our creative congressional solutions for the farm and budget crises are going to work. We can't second guess a market in which there is a continual surplus. It is time we recognized that agricultural producers in this country come first.

This legislation is fair, it is reasonable, it is fiscal common sense. And I hope to see that this Congress will take a sensible approach to our budget problems by enacting the Foreign Agricultural Investment Reform Act.

In the House budget resolution that will be debated starting this week, we have been able to interject the concept of FAIR in that whole budget approach, and I hope we can carry it through in a complete form.

Mr. Chairman, I also have testimony from Lieutenant Governor Dave Leroy of Idaho. Through his state office and his position as head of the District Export Council he's worked to promote agricultural exports, and I know in working with Lieutenant Governor Leroy throughout the last several years as he served as chairman of this task force, he has found oftentimes great frustration in every initiative that's offered that would promote agricultural exports from Idaho to find out that we are underbid and undersold by cheap commodities coming in from third world countries whose impetus for production came from these multi or international financing instruments that I spoke about in my statement.

I would like to submit Lieutenant Governor Dave Leroy's statement for the record. I think it's timely.

Senator SYMMS. Without objection, it will be part of the record.

Representative CRAIG. It speaks to the problems of Idaho, Mr. Chairman, and I think it speaks of the general issue and the specific issues that you address in your hearing here today and that I have attempted to address in my statement.

[The statement of Hon. David H. Leroy follows:]

STATEMENT OF

IDAHO LIEUTENANT GOVERNOR DAVID H. LEROY

AS LIEUTENANT GOVERNOR FOR THE STATE OF IDAHO, I HAVE WORKED VIGOROUSLY TO PROMOTE THE SALE OF IDAHO PRODUCTS IN INTERNATIONAL MARKETS.

MORE AND MORE, IT HAS BECOME EVIDENT TO ME THAT UNANTICIPATED CONSEQUENCES OF MANY WORLD BANK AND UNITED NATIONS PROGRAMS HAVE BEEN TO DIMINISH OR KILL LONG EXISTING MARKETS FOR AMERICAN FOOD AND FOREST PRODUCTS. ALSO, TO DISCOURAGE OPPORTUNITIES FOR THE DEVELOPMENT OF NEW MARKETS FOR THE PRODUCTS OF AMERICAN FARMS AND FORESTS.

I CONSIDER IT SOPHOMORIC IDEALISM THAT WE ATTEMPT TO BE ALL THINGS TO ALL PEOPLE AT ALL TIMES. I AM A STRONG ADVOCATE FOR FREE TRADE AND ENCOURAGEMENT OF INTERNATIONAL COMMERCE. HOWEVER, I FIND IT UNBELIEVABLE THAT WE FOSTER AND SUBSIDIZE COMPETITIVE PRODUCTION OF COMMODITIES THAT ARE IN ABUNDANT SUPPLY OR ACTUALLY IN SURPLUS.

I STRONGLY ENDORSE THE CONCEPTS OF H.R. 3643 AND SENATE BILL 1810.

IF AMERICAN CONTRIBUTIONS TO THE WORLD BANK ARE REDUCED BY AN AMOUNT IDENTICAL TO THE U.S. PROPORTION OF LOANS MADE FOR THE

PRODUCTION OF SURPLUS COMMODITIES, THEN THERE WILL BE AT LEAST ONE STRONG AMERICAN INFLUENCE TO REDUCE OR ELIMINATE THIS UNBELIEVABLE PRACTICE OF PERMITTING OUR OWN TAX DOLLARS TO CLOSE OFF OUR EXISTING EXPORT MARKETS.

THE FURTHER PROVISION, THAT OF USING THE MONEY SO SAVED TO REDUCE OUR NATIONAL DEBT, IS ALSO A WORTHY GOAL. I STRONGLY ENDORSE THE ACHIEVEMENT OF THESE GOALS IN THE INTEREST OF RESTORING THE FULL USE OF OUR FORESTS AND FARMS FOR WORLDWIDE MARKETS.

Senator SYMMS. Congressman Craig, thank you very much for excellent testimony.

Earlier this morning Senator Nickles from Oklahoma testified and he made a rather shocking statement, and that is, in comparison with the figure that had come up that the farmers in Brazil have a per capita earnings of $400 a year, the average net farm income on family farms or on farms in Oklahoma this past year was $18.

Do you have any numbers from our state to reflect where we are?

Representative CRAIG. Mr. Chairman, I do not have, but I know the situation firsthand from my own experience with our family farming and ranching operation, from town meetings across the district, from working directly with farmers and ranchers as you have over the last several years. In knowing their situation, I know of no other time in Idaho's agricultural history that we are as bad off as we are today.

Family farmers are going under in great numbers or merely hanging on or merely hanging on because the financial institution with which they do business has been able to put together some degree of forebearance that gives them at least another chance for this farm year. But if they don't show a positive cash flow, if they are not able to respond with some debt reduction in this current cycle, they are going to be out of business.

I spoke of the bank that we just lost in Idaho. There is no question that that bank was lost primarily because of bad agricultural loans, once good loans, but because of the change in the economic climate now bad loans.

I know few of my friends and neighbors who are in farming and ranching today that made any money in 1985 and I would suspect that the figure that Senator Nickles spoke of is very reminiscent of the situation in Idaho. Yes, we have a few who are successful, for whatever reasons, but we have the many who have been successful who are today in desperate financial trouble, in large part not due to their own doing but because of circumstances beyond the borders of Idaho, beyond their ability as managers to cope with and adjust to as the market changed and who simply did not expect a long-term down trend in commodity prices that continually forced them to change their operating practices to attempt to refinance in a negative cash flow situation.

Senator SYMMS. Thank you very much and I thank you for your enthusiastic support of the FAIR bill on the House side. We mentioned here earlier that we passed it through the Senate once to establish that the votes are there to pass it and I think that if we can get it to a vote and get the parliamentary situation correct on both the House and Senate side that the votes would be there because common sense tells us that it is fine to have a competitive economy and competitive trade. But to finance your own competition just lacks all common sense and I think we should, as you say, be somewhat selective in what we are going to do with respect to continuation of loans that are literally financing the competition to put American farmers out of work.

So thank you very much for your testimony.

The subcommittee stands in recess for five minutes and then we will have one more witness, which is a very distinguished American, very well known, Mr. Howard J. Ruff, and we look forward to having his testimony in about five minutes.

[A brief recess was taken.]

Senator SYMMS. The subcommittee will resume the hearing.

Our next witness is Mr. Howard J. Ruff. We are delighted to have Mr. Ruff here. He is a well known financial adviser, has a following from one end of this country to the other, plus in other parts of the world. I have had the opportunity to be with him on numerous occasions and recently last week when you had a convention in San Diego we had a TV hookup with Congressman Kemp and myself and Senator Dole and Senator Wallop. It was a very interesting interview that you did and a lot has happened since that interview as a matter of fact. Some things have happened in the Senate Finance Committee that I was really not confident would happen at the time we had that interview, but sometimes there are surprises in this town that are encouraging, and I think that the dramatic action of the Senate Finance Committee is one that you spoke of that day that you heartily would endorse in part. There's always problems. The problem of it is, as you know, from your long background of studying enconomics and so forth there is no Santa Clause and everything has some kind of a trade-off and those are the hard parts of tax reform legislation.

Mr. Ruff, we welcome you here to the subcommittee and thank you for being here to contribute to our record. Please go ahead.

## STATEMENT OF HOWARD J. RUFF, CHAIRMAN OF THE BOARD, FREE THE EAGLE CITIZEN'S LOBBY

Mr. RUFF. Thank you, Senator. I am the chairman of the board of Free the Eagle Citizen's Lobby, which is a grassroots lobby representing 265,000 Americans across the country who have contributed to support our efforts with an average contribution of about $25 each.

Free the Eagle has been concerned not only with the problems of debt overload on the economy of the United States, but also the debt of third world and communist countries.

Free the Eagle supports S. 1810, the Foreign Agricultural Investment Reform or FAIR bill, because this is the first legislation that I have seen which will create incentives for the IMF and other multilateral banks to stop undermining a critical U.S. industry—the American farmer. Free the Eagle was the leader of the opposition to the big bank bailout of 1983 when taxpayer funds were sent to the IMF for the purpose of rolling over bad debts acquired by third world and Eastern Bloc countries.

The economic reasoning for our opposition was correct. While the prescription of the IMF and the banks to roll over these debts has treated the symptoms, it has proven to be the disease itself. Since the 1983 bank bailout, the debts of these countries have gone from around $600 billion to almost $1 trillion. In 1983 former Treasury Secretary William E. Simon warned us that piling debt upon debt cannot ultimately succeed and that the final bankruptcy will be far worse.

Free the Eagle will fight for this bill as adamantly as it opposed the big bank bailout in 1983. Multilateral banks cannot continue to be allowed to create "quick fixes" for their loan problems by further glutting world agricultural markets in order to collect interest payments. Free the Eagle believes that the FAIR bill addresses principles that apply to other industries besides agriculture, and we admit that it only treats a tip of the iceberg. However, FAIR is a beginning with promise and a new direction. FAIR can be part of a long-term international monetary solution based upon free market principles. In order to understand the bill's merits, it is important to relate the world economy to the debt crisis and the banking system.

A film that we have provided called, "The Moneylenders," portrays the effect of this debt on the international economy. If we can view it now, I think it will frame the issue for future discussion as to what really is fair.

[Film shown.]

Senator SYMMS. That's most dramatic and, as the saying goes, a picture is worth a thousand words. That says a lot in a very brief time. I hope that can be seen by millions of Americans.

Mr. RUFF. We intend to see that it is and it clearly relates now to the issues specifically addressed by this bill, Senator.

It is ever clearer that the size, instability, and drag of this debt distorts many of the fundamental elements of growth and productivity. The distortions of this "debt overhang" have created a new kind of economy, the debt service economy.

International banks and other financial institutions have attempted to preserve foreign defaulted loans at face value and high interest rates. The only result is more debt and greater economic instability and danger that rots away the foundations of the free world financial structure. IMF austerity policies that decrease debtor countries' imports and artificially increases their exports have re-oriented them away from creating a sound infrastructure for the local economy and siphoned off desperately needed foreign exchange.

A symptom of the distortions of a debt service economy is capital flight, which destroys local confidence in the countries' currencies. Natives of many foreign countries have seen loaned dollars pour into their countries in enormous quantities. Wealthy people then exchange local currency for dollars, as shown in the film, and send it abroad to avoid either local hyper-inflation if IMF austerity is not observed, or possible revolution if it is. This illustrates how out-of-control lending and IMF policy has driven out capital, impoverishing poor people and leaving everyone worse off.

If capital fight had not occurred, according to Business Week, Mexico's debt might have been reduced by $85 billion, Argentina's reduced from $50 billion to $1 billion, and Venezuela's debt might be completely eradicated.

The principle IMF solution is to subsidize these countries to export at all costs, generally to the United States. The House Banking Committee recently held hearings where the costs to the U.S. economy caused by the third world debt crisis were discussed. Several economists pointed out that as much as half of our balance

of payments problems were the result of debt service motivated imports.

Debt service imports are best defined as products sold in this country that were created abroad for the purpose of raising cash to make interest payments. In many cases the products are not produced in a normal response to market demand. Take, for example, the recent $350 million loan to produce grain in Argentina sponsored by the World Bank. Argentina is one of the richest agricultural communities in the world. Furthermore, last Wednesday's Wall Street Journal article reported that the Asian Development Bank lent $584 million to the government of Burma, an authoritarian socialist regime. The article itself says it best:

> Struggling (American) farmers . . . are going to be taxed to subsidize a government-sanctioned project in a socialist country that usually opposes U.S. interests—and all to make a farm product that will cost Burmese consumers three times the world price.

And try to explain that loan to an Idaho farmer.

Zaire exports copper to this country so cheaply that it is destroying U.S. production. The Congress passed a resolution last year instructing the U.S. World Bank representatives to vote against loans which subsidize such production. Such steps, however, fall short of attacking the root of the problem, which requires changing the way the International Monetary Fund, the World Bank, and private banks loan money to these countries.

The United States is the world's principal innovator in agriculture yet it has found itself subsidizing its competition through tax dollars given to multinational banks. Agricultural products flood into the United States as the result of cash hungry countries converting their resources into agricultural products to feed the insatiable debt service beast. If multinational banks stopped dumping money into flooded world agricultural markets, the American farmer would not need the subsidies he is receiving from the Federal Government. If countries were not encouraged to invest in glutted agricultural world markets, their long-term financial outlook would be more promising.

The film clip shown moments ago showed a steel mill in Brazil which was financed with IMF money and built exclusively for export production. It was never completed. This shows how the IMF many times fosters economic cannibalism and tells countries that they must consume their resources to maintain unrealistic repayment schedules to maintain fictional good credit on a fictional face value of bank loan portfolios at the expense of all else. There are similar examples in copper, textiles, and, of course, agriculture.

It is time for frankness. The banks with their lust for profit loaned out their entire capital to debtors who cannot repay even the interest, let alone the principal amount. It is past time to admit what the banks refuse to admit and adjust public policy accordingly.

We must defang the debt service economy from doing further damage to our own economy. To do so the IMF must be curbed from further disorienting these debt service economies towards repayment of debts which are both impractical and impossible to repay. The only beneficiaries of current policy are the Bank's public relations campaigns to preserve their dignity. The banks are

content to roll over these debts endlessly as it makes their books appear current and their sick assets appear sound. These assets are building a house of cards.

The IMF lost its real purpose for existence and became a tool of the Bank's dilemma in 1972 when gold was detached from the currencies of the world. The IMF and World Bank must be restrained from making further loans to subsidize production in glutted world markets which only displace American products and American workers. Even the Garn amendment on IMF copper subsidies has not restored any U.S. workers' jobs in the copper industry because the IMF suffers no penalty for its policies. S. 1810, however, takes dollar for dollar from the IMF if it chooses to financially support agricultural production that adds to glutted markets.

Apparently nothing short of this will redirect IMF towards a more capitalist system which responds to an undistorted supply and demand economy. Present multinational lending policies are drawing the world economy further and further away from free market principles. U.S. agricultural exports are declining at 7 percent a year because the United States has dumped billions into multilateral banks that needlessly subsidize world production which pours into already glutted markets. This simply is not fair to the beleaguered American farmer.

The long term health of third world borrowers can only be built upon industries that provide goods and services to be consumed primarily in their own countries. These countries need to create jobs that the local economy can support based on sound capital investment. Such a policy will foster a growing middle class. Too often IMF loans have subsidized production of products which the countries cannot consume internally. This production is capital intensive, and does little or nothing to contribute to sound economic growth in these countries. The long term effects of IMF and World Bank policies will create a new form of mercantilism benefiting the banks, not the economies of these countries.

As strong as it is, our economy cannot handle the strain of becoming the dumping ground for products made, mined, or grown only to finance debt service economies. It is putting our own factory workers and farmers on the welfare rolls.

We cannot afford to let banks make unaccountable loans for which they then expect Uncle Sam directly or through the IMF or World Bank to make good. S. 1810 creates the right incentives for the first time to impose sound economic policy on IMF policy. It is heartening that the Senate already voted 65 to 13 passing this bill as an amendment to the Senate farm bill last fall. It is my hope that the whole Congress will see fit to take this modest but much needed step to begin to reform the IMF/World Bank lending practices. Additional reforms that won't be accomplished in this bill but are equally important are the following: A structured write down of these debts over say a ten-year period; preventing pseudo insurance for loans by the World Bank; risk-related FDIC insurance premiums for banks who make irresponsible loans; and finally, control and regulation of loans to communist countries. Thank you.

[The prepared statement of Mr. Ruff follows:]

PREPARED STATEMENT OF HOWARD J. RUFF

THANK YOU SENATOR SYMMS. MY NAME IS HOWARD J. RUFF. I AM THE CHAIRMAN OF THE BOARD OF FREE THE EAGLE CITIZEN'S LOBBY, A GRASS ROOTS LOBBY REPRESENTING 265,000 AMERICANS ACROSS THE COUNTRY. FTE HAS BEEN CONCERNED NOT ONLY WITH THE PROBLEMS OF DEBT OVERLOAD ON THE ECONOMY OF THE UNITED STATES, BUT ALSO THE DEBT OF THIRD WORLD AND COMMUNIST COUNTRIES.

FREE THE EAGLE SUPPORTS S. 1810, THE FOREIGN AGRICULTURAL INVESTMENT REFORM (FAIR) BILL, BECAUSE THIS IS THE FIRST LEGISLATION WHICH WILL CREATE INCENTIVES FOR THE IMF AND OTHER MULTILATERAL BANKS TO STOP UNDERMINING A CRITICAL U.S. INDUSTRY -- THE AMERICAN FARMER. FTE WAS THE LEADER OF THE OPPOSITION TO BIG BANK BAILOUT OF 1983 WHEN TAXPAYER FUNDS WERE SENT TO THE IMF FOR THE PURPOSE OF ROLLING OVER BAD DEBTS ACQUIRED BY THIRD WORLD AND EASTERN BLOC COUNTRIES.

THE ECONOMIC REASONING FOR OUR OPPOSITION WAS CORRECT. WHILE THE PRESCRIPTION OF THE IMF AND THE BANKS TO ROLL OVER THESE DEBTS HAS TREATED THE SYMPTOMS, IT HAS PROVEN TO BE THE DISEASE ITSELF. SINCE THE BIG BANK BAILOUT, THE DEBTS OF THESE COUNTRIES HAVE GONE FROM AROUND 600 BILLION TO ALMOST A TRILLION DOLLARS. IN 1983 FORMER TREASURY SECRETARY WILLIAM E. SIMON WARNED US THAT PILING DEBT UPON DEBT CANNOT ULTIMATELY SUCCEED AND THAT THE FINAL BANKRUPTCY WILL BE FAR WORSE. 1

FTE WILL FIGHT FOR THIS BILL AS ADAMANTLY AS IT OPPOSED THE

BIG BANK BAILOUT IN 1983. MULTILATERAL BANKS CANNOT BE ALLOWED TO CREATE "QUICK FIXES" FOR THEIR LOAN PROBLEMS BY FURTHER GLUTTING WORLD AGRICULTURAL MARKETS IN ORDER TO COLLECT INTEREST PAYMENTS. FTE BELIEVES THAT THE FAIR BILL ADDRESSES PRINCIPLES THAT APPLY TO OTHER INDUSTRIES BESIDES AGRICULTURE, AND WE ADMIT THAT IT ONLY TREATS A TIP OF THE ICEBERG. HOWEVER, FAIR IS A BEGINNING WITH PROMISE AND A NEW DIRECTION. FAIR CAN BE PART OF A LONG-TERM INTERNATIONAL MONETARY SOLUTION BASED UPON FREE MARKET PRINCIPLES. IN ORDER TO UNDERSTAND THE BILL'S MERITS, IT IS IMPORTANT TO RELATE THE WORLD ECONOMY TO THE DEBT CRISIS AND THE BANKING SYSTEM.

A FILM THAT WE HAVE PROVIDED CALLED, "THE MONEYLENDERS," PORTRAYS THE EFFECT OF THIS DEBT ON THE INTERNATIONAL ECONOMY. IF WE CAN VIEW IT NOW, I THINK IT WILL FRAME THE ISSUE FOR FUTURE DISCUSSION AS TO WHAT REALLY IS FAIR. (SHOW FILM)

IT IS EVER CLEARER THAT THE SIZE, INSTABILITY, AND DRAG OF THIS DEBT DISTORTS MANY OF THE FUNDAMENTAL ELEMENTS OF GROWTH AND PRODUCTIVITY. THE DISTORTIONS OF THIS "DEBT OVERHANG" HAVE CREATED A NEW KIND OF ECONOMY, THE DEBT SERVICE ECONOMY.

## THE DEBT SERVICE ECONOMY

INTERNATIONAL BANKS AND OTHER FINANCIAL INSTITUTIONS HAVE ATTEMPTED TO PRESERVE FOREIGN DEFAULTED LOANS AT FACE VALUE AND HIGH INTEREST RATES.2 THE ONLY RESULT IS MORE DEBT AND GREATER

ECONOMIC INSTABILITY AND DANGER THAT ROTS AWAY THE FOUNDATIONS OF THE FREE WORLD FINANCIAL STRUCTURE. IMF AUSTERITY POLICIES THAT DECREASE DEBTOR COUNTRIES' IMPORTS AND ARTIFICIALLY INCREASE THEIR EXPORTS HAVE RE-ORIENTED THEM AWAY FROM CREATING A SOUND INFRASTRUCTURE FOR THE LOCAL ECONOMY AND SIPHONED-OFF DESPERATELY NEEDED FOREIGN EXCHANGE.

A SYMPTOM OF THE DISTORTIONS OF A DEBT SERVICE ECONOMY IS CAPITAL FLIGHT, WHICH DESTROYS LOCAL CONFIDENCE IN THE COUNTRIES' CURRENCIES. NATIVES OF MANY FOREIGN COUNTRIES HAVE SEEN LOANED DOLLARS POUR INTO THEIR COUNTRIES IN ENORMOUS QUANTITIES. WEALTHY PEOPLE THEN EXCHANGE LOCAL CURRENCY FOR DOLLARS, AND SEND IT ABROAD TO AVOID EITHER LOCAL HYPER-INFLATION IF IMF AUSTERITY IS NOT OBSERVED, OR POSSIBLE REVOLUTION IF IT IS. THIS ILLUSTRATES HOW OUT-OF-CONTROL LENDING AND IMF POLICY HAS DRIVEN OUT CAPITAL, IMPOVERISHING POOR PEOPLE AND LEAVING EVERYONE WORSE OFF.

IF CAPITAL FLIGHT HAD NOT OCCURRED, MEXICO'S DEBT MIGHT HAVE BEEN REDUCED BY 85 BILLION DOLLARS, ARGENTINA'S REDUCED FROM 50 BILLION TO ONE BILLION DOLLARS, AND VENEZUELA'S DEBT MIGHT BE COMPLETELY IRRADICATED.3

THE PRINCIPLE IMF SOLUTION IS TO SUBSIDIZE THESE COUNTRIES TO EXPORT AT ALL COSTS, GENERALLY TO THE UNITED STATES. THE HOUSE BANKING COMMITTEE RECENTLY HELD HEARINGS WHERE THE COSTS TO THE U.S. ECONOMY CAUSED BY THE THIRD WORLD DEBT CRISIS WERE DISCUSSED. SEVERAL ECONOMISTS POINTED OUT THAT AS MUCH AS HALF

OF OUR BALANCE OF PAYMENTS PROBLEMS WERE THE RESULT OF DEBT SERVICE MOTIVATED IMPORTS. 4

DEBT SERVICE IMPORTS ARE BEST DEFINED AS PRODUCTS SOLD IN THIS COUNTRY THAT WERE CREATED ABROAD FOR THE PURPOSE OF RAISING CASH TO MAKE INTEREST PAYMENTS. IN MANY CASES THE PRODUCTS ARE NOT PRODUCED IN A NORMAL RESPONSE TO MARKET DEMAND. TAKE FOR EXAMPLE THE RECENT $350 MILLION LOAN TO PRODUCE GRAIN IN ARGENTINA SPONSORED BY THE WORLD BANK. 5 ARGENTINA IS ONE OF THE RICHEST AGRICULTURAL COMMUNITIES IN THE WORLD. FURTHERMORE, LAST WEDNESDAY'S WALL STREET JOURNAL ARTICLE REPORTED THAT THE ASIAN DEVELOPMENT BANK LENT $584 MILLION TO THE GOVERNMENT OF BURMA, A AUTHORITARIAN SOCIALIST REGIME. THE ARTICLE ITSELF SAYS IT BEST: "STRUGGLING [AMERICAN] FARMERS . . . ARE GOING TO BE TAXED TO SUBSIDIZE A GOVERNMENT-SANCTIONED PROJECT IN A SOCIALIST COUNTRY THAT USUALLY OPPOSES U.S. INTERESTS -- AND ALL TO MAKE A FARM PRODUCT THAT WILL COST BURMESE CONSUMERS THREE TIMES THE WORLD PRICE." 6 AND TRY TO EXPLAIN THAT LOAN TO AN IDAHO FARMER.

ZAIRE EXPORTS COPPER TO THIS COUNTRY SO CHEAPLY THAT IT IS DESTROYING U.S. PRODUCTION. 7 THE CONGRESS PASSED A RESOLUTION LAST YEAR INSTRUCTING THE U.S. WORLD BANK REPRESENTATIVES TO VOTE AGAINST LOANS WHICH SUBSIDIZE SUCH PRODUCTION. SUCH STEPS HOWEVER FALL SHORT OF ATTACKING THE ROOT OF THE PROBLEM, WHICH REQUIRES CHANGING THE WAY THE INTERNATIONAL MONETARY FUND, THE WORLD BANK, AND PRIVATE BANKS LOAN MONEY TO THESE COUNTRIES.

THE UNITED STATES IS THE WORLD'S PRINCIPLE INNOVATOR IN

AGRICULTURE YET IT HAS FOUND ITSELF SUBSIDIZING ITS COMPETITION THROUGH TAX DOLLARS GIVEN TO MULTILATERAL BANKS. AGRICULTURAL PRODUCTS FLOOD INTO THE UNITED STATES AS THE RESULT OF CASH HUNGRY COUNTRIES CONVERTING THEIR RESOURCES INTO AGRICULTURAL PRODUCTS TO FEED THE INSATIABLE DEBT SERVICE BEAST. IF MULTILATERAL BANKS STOPPED DUMPING MONEY INTO FLOODED WORLD AGRICULTURAL MARKETS, THE AMERICAN FARMER WOULD NOT NEED THE SUBSIDIES HE IS RECEIVING FROM THE FEDERAL GOVERNMENT. IF COUNTRIES WERE NOT ENCOURAGED TO INVEST IN GLUTTED AGRICULTURAL WORLD MARKETS, THEIR LONG-TERM FINANCIAL OUTLOOK WILL BE MORE PROMISING.

THE FILM CLIP SHOWED MOMENTS AGO SHOWED A STEEL MILL IN BRAZIL WHICH WAS FINANCED WITH IMF MONEY AND BUILT EXCLUSIVELY FOR EXPORT PRODUCTION. IT WAS NEVER COMPLETED. THIS SHOWS HOW THE IMF MANY TIMES FOSTERS ECONOMIC CANNIBALISM AND TELLS COUNTRIES THAT THEY MUST CONSUME THEIR RESOURCES TO MAINTAIN UNREALISTIC REPAYMENT SCHEDULES TO MAINTAIN FICTIONAL GOOD CREDIT ON A FICTIONAL FACE VALUE OF BANK LOAN PORTFOLIOS AT THE EXPENSE OF ALL ELSE. THERE ARE SIMILAR EXAMPLES IN COPPER, TEXTILES, AND OF COURSE, AGRICULTURE.

## RECOMMENDATIONS

IT IS TIME FOR FRANKNESS. THE BANKS WITH THEIR LUST FOR PROFIT, LOANED OUT THEIR ENTIRE CAPITAL TO DEBTORS WHO CANNOT REPAY EVEN THE INTEREST, LET ALONE THE PRINCIPAL AMOUNT. IT IS

PAST TIME TO ADMIT WHAT THE BANKS REFUSE TO ADMIT AND ADJUST PUBLIC POLICY ACCORDINGLY.

WE MUST DEFANG THE DEBT SERVICE ECONOMY FROM DOING FURTHER DAMAGE TO OUR OWN ECONOMY. TO DO SO THE IMF MUST BE CURBED FROM FURTHER DISORIENTING THESE DEBT SERVICE ECONOMIES TOWARDS REPAYMENT OF DEBTS WHICH ARE BOTH IMPRACTICAL AND IMPOSSIBLE TO REPAY. THE ONLY BENEFICIARIES OF CURRENT POLICY ARE THE BANK'S PUBLIC RELATIONS CAMPAIGNS TO PRESERVE THEIR DIGNITY. THE BANKS ARE CONTENT TO ROLL OVER THESE DEBTS ENDLESSLY AS IT MAKES THEIR BOOKS APPEAR CURRENT AND THEIR SICK ASSETS APPEAR SOUND. THESE ASSETS ARE BUILDING A HOUSE OF CARDS.

THE IMF LOST ITS REAL PURPOSE FOR EXISTENCE AND BECAME A TOOL OF THE BANK'S DILEMMA IN 1972 WHEN GOLD WAS DETACHED FROM THE CURRENCIES OF THE WORLD. THE IMF MUST BE RESTRAINED FROM MAKING FURTHER LOANS TO SUBSIDIZE PRODUCTION IN GLUTTED WORLD MARKETS WHICH ONLY DISPLACE AMERICAN PRODUCTS AND AMERICAN WORKERS. EVEN THE GARN AMENDMENT ON IMF COPPER SUBSIDIES HAS NOT RESTORED ANY U.S. WORKERS' JOBS IN THE COPPER INDUSTRY BECAUSE THE IMF SUFFERS NO PENALTY FOR ITS POLICIES. S. 1810, HOWEVER, TAKES DOLLAR FOR DOLLAR FROM THE IMF IF IT CHOOSES TO FINANCIALLY SUPPORT AGRICULTURAL PRODUCTION THAT ADDS TO GLUTTED MARKETS.

APPARENTLY NOTHING SHORT OF THIS WILL REDIRECT IMF TOWARDS A MORE CAPITALIST SYSTEM WHICH RESPONDS TO A UNDISTORTED SUPPLY AND DEMAND ECONOMY. PRESENT MULTILATERAL LENDING POLICIES ARE DRAWING THE WORLD ECONOMY FURTHER AND FURTHER AWAY FROM FREE

MARKET PRINCIPLES. U.S AGRICULTURAL EXPORTS ARE DECLINING AT 7% A YEAR BECAUSE THE UNITED STATES HAS DUMPED BILLIONS INTO MULTILATERAL BANKS THAT NEEDLESSLY SUBSIDIZE WORLD PRODUCTION WHICH POURS INTO ALREADY-GLUTTED MARKETS. THIS SIMPLY IS NOT FAIR TO THE BELEAGUERED AMERICAN FARMER.

## CONCLUSION

THE LONG TERM HEALTH OF THIRD WORLD BORROWERS CAN ONLY BE BUILT UPON INDUSTRIES THAT PROVIDE GOODS AND SERVICES TO BE CONSUMED PRIMARILY IN THEIR OWN COUNTRIES. THESE COUNTRIES NEED TO CREATE JOBS THAT THE LOCAL ECONOMY CAN SUPPORT BASED ON SOUND CAPITAL INVESTMENT. SUCH A POLICY WILL FOSTER A GROWING MIDDLE CLASS. TOO OFTEN IMF LOANS HAVE SUBSIDIZED PRODUCTION OF PRODUCTS WHICH THE COUNTRIES CANNOT CONSUME INTERNALLY. THIS PRODUCTION IS CAPITAL INTENSIVE, AND DOES LITTLE OR NOTHING TO CONTRIBUTE TO SOUND ECONOMIC GROWTH IN THESE COUNTRIES. THE LONG TERM EFFECTS OF IMF/WORLD BANK POLICIES WILL CREATE A NEW FORM OF MERCANTILISM BENEFITTING THE BANKS, NOT ECONOMIES OF THESE COUNTRIES.

AS STRONG AS IT IS, OUR ECONOMY CANNOT HANDLE THE STRAIN OF BECOMING THE DUMPING GROUND FOR PRODUCTS MADE, MINED, OR GROWN ONLY TO FINANCE DEBT SERVICE ECONOMIES. IT IS PUTTING OUR OWN FACTORY WORKERS AND FARMERS ON THE WELFARE ROLLS.

WE CANNOT AFFORD TO LET BANKS MAKE UNACCOUNTABLE LOANS FOR WHICH THEY THEN EXPECT UNCLE SAM DIRECTLY OR THROUGH THE IMF OR WORLD BANK TO MAKE GOOD. S. 1810 CREATES THE RIGHT INCENTIVES FOR THE FIRST TIME TO IMPOSE SOUND ECONOMIC POLICY ON IMF POLICY. IT IS HEARTENING THAT THE SENATE ALREADY VOTED 65 TO 13 PASSING THIS BILL AS AN AMENDMENT TO THE SENATE FARM BILL LAST FALL. IT IS MY HOPE THAT THE WHOLE CONGRESS WILL SEE FIT TO TAKE THIS MODEST BUT MUCH NEEDED STEP TO BEGIN TO REFORM THE IMF/WORLD BANK LENDING PRACTICES. ADDITIONAL REFORMS THAT WON'T BE ACCOMPLISHED IN THIS BILL BUT ARE EQUALLY IMPORTANT ARE THE FOLLOWING: A STRUCTURED WRITE DOWN OF THESE DEBTS OVER SAY A TEN YEAR PERIOD; PREVENTING PSEUDO INSURANCE FOR LOANS BY THE WORLD BANK; RISK RELATED FDIC INSURANCE PREMIUMS FOR BANKS WHO MAKE IRRESPONSIBLE LOANS; AND FINALLY, CONTROL AND REGULATION OF LOANS TO COMMUNIST COUNTRIES. THANK YOU.

## SOURCES


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4. HOUSE BANKING COMMITTEE -- Subcommittee on International Development, March 19, 1986.

5. WORLD BANK NEWS RELEASE -- # 86-68.

6. WALL STREET JOURNAL -- "Burma Shave" May 7, 1986.

7. UNITED STATES CENSUS BUREAU 1983 --- Copper Import Figures.

APPENDIX TITLE PAGE

I: Quote by William Simon, former Secretary of the Treasury of the United States.

II: Article -- The Banks Latest Game: Loan Swapping.

III: Graph -- How Capital Flight has effected the Third World.

IV: Article -- Has Capital Flight Made the U.S. a Debtor of Latin America?

V. Article -- The Real Foreign Debt Problem.

VI: Graph -- A Narrowing Agricultural Trade Surplus.

VII: Article -- American Food Exports Drop Sharply While Imports Rise.

VIII: Article -- Burma Shave.

IX: Article -- How to Resolve Latin America's Debt Crisis November/December 1985.

APPENDIX I

**The Wall Street Journal, April 6, 1983**

*"But when fear comes in, reason departs, and piling debt upon debt cannot ultimately succeed. It not only delays the day of reckoning but exacts a high price: By extending credit to countries beyond their ability to repay, the final bankruptcy is worse...."*

WILLIAM SIMON

Former Secretary of the Treasury

INTERNATIONAL FINANCE/GARY HECTOR

# THE BANKS' LATEST GAME: LOAN SWAPPING

■ A few adventurous commercial banks have started trading shaky international loans the way grammar school kids trade baseball cards. The bankers play by swapping loans that make them extremely uncomfortable for loans that make them a little less uncomfortable. The strategy—aggressive by banking standards—centers on problem loans to Latin American countries.

The leading player is New York's Bankers Trust, the nation's eighth-largest bank. It has completed nearly a dozen swaps this year, and in doing so reduced its exposure to Brazil, one of the world's more vexed economies (see the article on page 116). This has raised hackles because Bankers Trust is on the advisory committee that is currently trying to persuade some 800 banks to ante up an additional $6.5 billion for Brazil. But other large lenders are intrigued by Bankers Trust's aggressive approach to managing its problem loans. While no other U.S. bank is known to be swapping, some are looking seriously at the deals that come their way. The market is still tiny, but it could grow as bankers bring increased ingenuity to managing high-risk portfolios.

The largest swap completed so far was an exchange of $290 million of Latin American debt. Bankers Trust made the trade with Banco Real, a privately owned Brazilian bank that, along with other Brazilian banks, has had trouble persuading foreign banks to keep money on deposit. Faced with a liquidity problem, Banco Real approached Bankers Trust offering to sell part of its loan portfolio for cash. But the loans consisted largely of Mexican paper, and Bankers Trust had plenty of that.

Still, the bank figured it might take on more Mexican loans if it could get rid of some Brazilian debt in the process. If Mexican paper is unpalatable to U.S. banks, Brazilian paper seems practically poisonous. Eventually the two banks struck a deal under which Banco Real swapped at face value $190 million of its loans—about 90% of them loans to Mexico. In exchange it received from Bankers Trust $90 million in cash and $100 million of Latin American loans—about 90% of them Brazilian.

The cash bailed Banco Real out of its liquidity squeeze and left it with additional loans to Brazilian borrowers, a position it preferred to holding nearly twice as much in loans to foreigners. The transaction had no immediate effect on Bankers Trust's profits, though it may eventually. Like all Brazilian loans, those the bank jettisoned—made to public and private borrowers—were perilously close to becoming nonperforming assets. Should that happen, U.S. bank regulators would likely require the bank to add to its loss reserves (which would require a charge against earnings). The Mexican loans Bankers Trust picked up seem far less likely to end up on the delinquency rolls. The bank also says it achieved some practical business objectives: it made a friend of Banco Real and acquired some Mexican borrowers that seem particularly attractive.

ILLUSTRATION BY LASZLO KUBINYI

MOST LENDERS would agree that Mexico is a better bet to repay its loans than Brazil. Yet other large U.S. banks say categorically that they aren't dabbling in swaps to change the mix of their portfolios. Even Citicorp, normally as daring as any, has apparently not found swaps palatable. Bankers Trust enjoys its activist approach to troublesome loans. Says Executive Vice President David K. Sias Jr., "We have not sat by passively since the problems developed." A runner who gets up at 3 A.M. once a week to jog 20 miles before work, Sias, 46, obviously thinks the deals are wise, even though they are devilish to negotiate. "It's a tedious, tedious business," he says. "You have to find out what the other bank wants, what you want, and then find a middle ground." This requires sifting through dozens of small loans to find a swappable mix.

Most deals being proposed to U.S. banks are tiny—a small fraction of the size of the Banco Real swap. The most strongly motivated sellers are Latin American banks, like Banco Real, facing liquidity problems. But many deals originate with small financial institutions outside the U.S. that want to bail out of their Latin American loans. A few of these loans have been put on the mar-

fast for much less than their face value and are trading in London like exotist bonds.

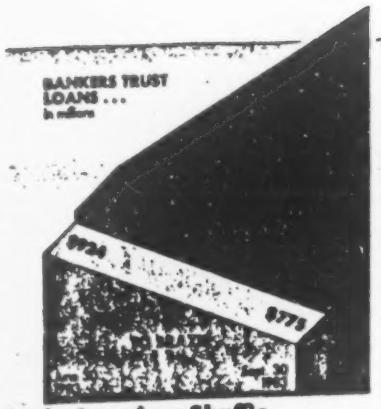
Some Middle Eastern and European banks have put their entire Latin American loan portfolios up for swap. A Middle Eastern bank, for example, has approached a few U.S. banks with a proposal to swap all of its Mexican debt in a deal worth close to $30 million. To make the transaction interesting, it offered to take a few million dollars in loans that had been totally written off. Structured correctly, such a deal could create an immediate profit for a U.S. bank by replacing loans carried on the books as worthless for loans considered to have value. A banker who has seen the deal says he thinks it has a good chance of being completed.

Bankers Trust won't divulge the details of its various swaps, but the overall effect shows up in its third-quarter filing with the Securities and Exchange Commission. During the quarter the bank reduced its loans to Brazil by $149 million while adding $235 million of loans to Mexico.

Privately, international bankers chastise Bankers Trust for making the job of restructuring loans to Brazil more difficult. "The reason we are not doing such swaps," sniffs a senior Latin American lender at a New York bank, "is that it is improper at this time. We are devoting our time to helping the various countries overcome a crisis. That's the first priority." Says a senior international officer at another New York bank who is trying to keep smaller U.S. banks from ducking out of the new Brazilian loan package: "I had a regional bank ask me yesterday, 'Why should we contribute when a member of the advisory committee is running out on Brazil?' "

With $775 million of Brazilian debt still on its books and $1.175 billion of Mexican debt, Bankers Trust hasn't exactly escaped Latin America's financial problems. In fact it will be anteing up for Brazil's latest loan restructuring in proportion to the loans on its books at the end of 1982, not its lower current loans.

Most bankers doubt that the swapping going on quietly between banks will ever become a big-time activity. Yet wherever there are risks, bankers will be looking for ways to reduce them, so the tedious business of swapping could catch on. ■




**Latin American Shuffle**
*Bankers Trust's Brazilian loans fell by $149 million last quarter, largely because they were swapped for less risky Mexican loans.*

RESEARCH ASSOCIATE *Monci Jo Williams*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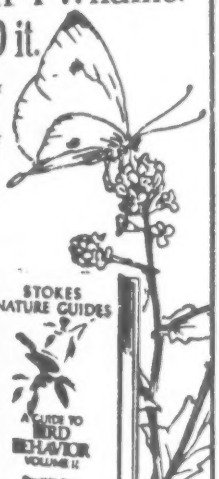

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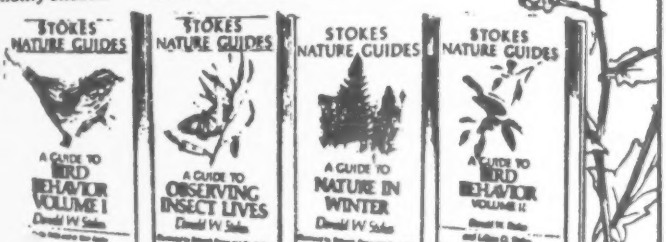
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APPENDIX III

BUSINESS WEEK/APRIL 21, 1986

## HOW CAPITAL FLIGHT HAS EXACERBATED THIRD WORLD DEBT

| | Gross external debt* Billions of dollars | |
|---|---|---|
| Nation | Actual | If there had been no capital flight |
| Argentina | $50 | $1 |
| Brazil | 106 | 92 |
| Mexico | 97 | 12 |
| Venezuela | 31 | 0 |
| Malaysia | 20 | 4 |
| Nigeria | 19 | 7 |
| Philippines | 27 | 15 |

*Yearend 1985

DATA: MORGAN GUARANTY TRUST CO. ESTIMATES

APPENDIX IV

# HAS CAPITAL FLIGHT MADE THE U.S. A DEBTOR OF LATIN AMERICA?

BUSINESS WEEK/APRIL 21, 1986

The Third World debt crisis is approaching a critical mass in the wake of crumbling oil prices and a still-sluggish world economy. Now economists—writing in both the popular press and professional publications—are zeroing in on a contributing factor that has been largely ignored in past discussions of solutions: the huge buildup of foreign assets held by citizens of debtor nations.

In an article in this week's issue of *The New Republic*, James S. Henry, former chief economist of McKinsey & Co., charges that much of the money lent to major debtor nations has been siphoned off by local "elites" and stashed abroad in private bank accounts and investments—primarily in the U.S. The culprits in this mammoth transfer of wealth: the upper classes in developing countries, who control their governments and economies and hence have used their influence to "facilitate" the outflow of capital; U.S. and other lender banks that first made imprudent loans and then, in their capacity as private bankers, played an active role in aiding foreigners to send cash out of their countries; and U.S. tax laws that have made the nation into a "tax haven" for Third World citizens.

Perhaps the most striking aspect of Henry's article is his picture of the extent of capital flight. Noting that Citibank, "the most aggressive American bank in international private banking (IPB)," has about $26 billion in IPB assets, he estimates that at least half probably belongs to Latin America, compared with Citibank's total loan exposure to Brazil, Mexico, Argentina, and Venezuela of $10.3 billion. Similarly, he estimates that U.S. banks as a whole, which hold about $83 billion in outstanding Latin debt, manage at least $60 billion and perhaps as much as $85 billion in private Latin American assets. In fact, the U.S. itself, he says, "is probably a net debtor of Latin American countries."

Are Henry's estimates accurate? A Citibank spokesman agrees that capital flight from developing nations is a problem, but he says the bank has never attempted to assess the size of its holdings of Latin American assets. "The answer is to create economic conditions that make it attractive to keep capital at home," he says.

Writing in a recent issue of *Challenge* magazine, economist David Felix of Washington University in St. Louis estimates that total Latin American assets in the U.S.—including liquid assets, real estate, and direct investment by Latin companies—are around $180 billion. He notes that a recent Banco de México study put capital flight at about $33 billion between 1977 and 1984, nearly half the gross inflow of capital to Mexico. And the World Bank estimated that Argentine and Venezuelan capital flight during 1978-82 amounted to 65% and 137%, respectively, of gross capital inflow. Indeed, in the latest issue of its *World Financial Markets*, Morgan Guaranty Trust Co. calculates that Argentina and Venezuela would have been almost debt-free today if they could have substituted the capital fleeing their soil for the loans and interest payments that replaced it (chart, page 14).

Both Henry and Felix believe Third World countries should be required to curb capital flight as a condition for further help. Henry also calls for more responsible behavior by U.S. banks and for reform of U.S. tax laws that encourage the phenomenon. Felix would go further and have Latin nations mobilize privately owned foreign assets by compelling their nationals to register their holdings and exchange them for local currency bonds, as Britain and France did during World War I. Such foreign assets would be deposited in a U.S. escrow account for the sole use of paying interest on foreign debt. Given the growing likelihood of loan defaults without such action, the banks might well cooperate in tracking down foreign assets.

"This strategy," says Felix, "may seem politically difficult, but it is likely to appear more and more feasible as the debt crisis worsens."

APPENDIX V

# The Real Foreign Debt Problem

By George B.N. Ayittey

Many leaders of nations saddled with a burdensome foreign debt find it convenient and popular to blame their plight on Western banks and governments while they allow rampant corruption and counterproductive economic policies to continue.

Peruvian President Alan Garcia—who has limited debt repayments to 10% of his country's export earnings—said recently: "Economic subjugation and foreign debt are the modern forms of what occupation and military blockade were in the past. The debt . . . has become a modern expression of imperialism." He described interest on foreign debt as a "brazen attempt to collect foreign currency and cover the deficit of the wealthy countries, especially the most powerful country."

Even those leaders of less-developed countries (LDCs) not given to overheated rhetoric propose solutions that address only the international aspects of the debt crisis. For example, the key proposals of the Cartagena Group of 11 Latin American debtor nations include lowering real international interest rates, securing concessionary terms on existing debt, and increasing annual International Monetary Fund lending to keep pace with international inflation. Debtor representatives are also using the IMF and World Bank meetings, which convene in Washington today, to ask for more lending on easier terms. Nowhere is there a concrete set of proposals by the debtor nations to tackle some of the worst domestic causes of the debt crisis: economic mismanagement, inflation, corruption, excessive government control of the economy and capital flight.

## Clandestine Nature

Capital flight—the legal or illegal export of foreign exchange—is perhaps the largest single obstacle to a resolution of the Third World debt crisis. Journalist Lenny Glynn writes that "there is growing evidence that capital flight from LDCs was a major factor behind the cash shortages that drove several of them to the brink of bankruptcy." James S. Henry, an economist writing in the New Republic, reports that "More than half of the money borrowed by Mexico, Venezuela, and Argentina during the last decade has effectively flowed right back out the door, often the same year or even month it flowed in."

What is the source of this capital? A great deal of it represents money invested abroad by those who have little or no faith in the management of their countries' economies. But much of it consists of tens of billions of dollars spirited out of the LDCs by corrupt officials since the 1970s. Owing to its clandestine nature, precise figures on much of the capital exodus are hard to come by. But in Canadian Report on Business magazine, Mr. Glynn cites a revealing confidential study carried out by a New York bank. After examining the balance-of-payment accounts of 23 debtor nations from 1976 to 1983, it was discovered that while those nations added $361.5 billion to their foreign debts, $103.1 billion flowed back out as capital flight. Some examples from that five-year period:

- Argentina incurred $35.7 billion in new loans while $21 billion left the country.
- The Philippines added on $19.1 billion in new debt as $6.9 billion left.
- Venezuelans spirited $27 billion out of their country while that nation's debt load rose by $23 billion.

These findings are corroborated by another study by the Bank for International Settlements. It found that, excluding Venezuela, some $55 billion left Latin America between 1976 and 1982.

If anything, capital flows are even greater today. At a recent Manhattan Institute luncheon, Walter Wriston, the former chairman of Citicorp, reported that in February alone, $3 billion in capital was sent out of Mexico. According to Mr. Wriston: "Most people believe that the flight of capital from Latin America on deposit in New York and Miami exceeds the total capital remaining in those countries." This hemorrhaging of financial assets means that further solutions to the debt crisis must come from the debtors themselves. As Mr. Wriston says: "There is no point in lending money to Mexico if they don't let their currency float, bring their inflation down, and reduce their deficit. There is nothing that a lender can do to help."

THE WALL STREET JOURNAL

TUESDAY, APRIL 8, 1986

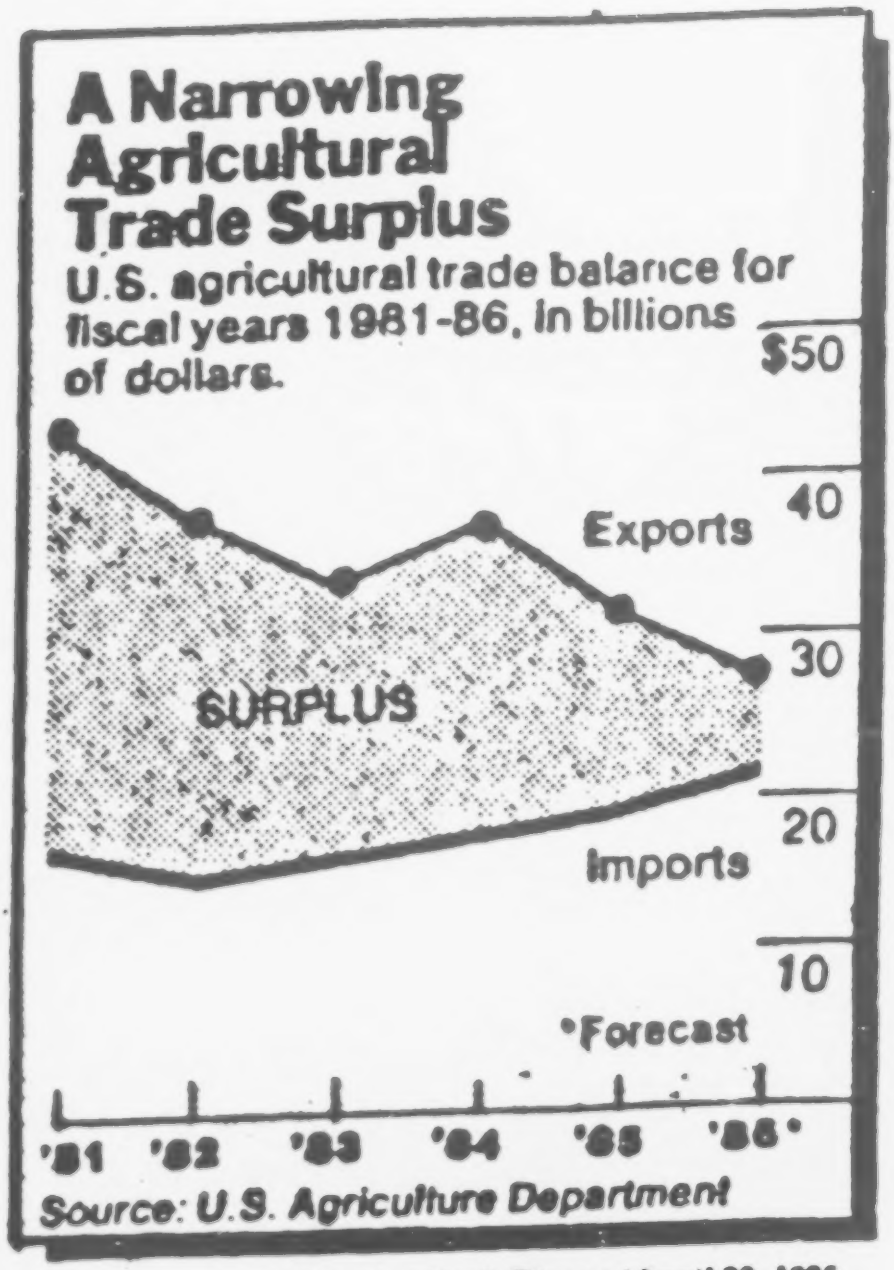
It is within this context that the plan proposed by Treasury Secretary James Baker last October to grapple with the debt crisis should be assessed. The Baker Plan envisages a pledge of $29 billion in new loans from Western commercial and development banks to the debtor nations. In return, the debtor nations would be required to pursue sound anti-inflationary policies and institute major structural reforms to reduce the role of the state in their economies, liberalize trade and arrest capital flight. In the next week, the World Bank and IMF will begin implementing this plan by setting up an initial $3.1 billion lending program largely for nations in sub-Saharan Africa.

In essence, the provisions of the Baker Plan do not differ radically from the austerity measures the IMF often already prescribes as conditions for its aid. Those conditions have been assailed in the past by LDC leaders as "offensive" and "politically suicidal." It is no surprise then that the reaction of the debtor nations to the Baker Plan was cool and disheartening. Only Argentina, Ecuador and Mexico expressed guarded willingness to endorse some of its aspects.

While leaders of the debtor nations overwhelmingly reject Mr. Baker's initiative, they don't propose a substitute that deals with the domestic side of the debt crisis. It is tragic that so many countries that struggled so long for their independence from colonial powers are now led by people who must wait for outsiders to come up with realistic solutions to their domestic economic problems. What proposals have these leaders ever made to solve the problems of capital flight, inflation and economic mismanagement?

That progress is possible is shown by the experience of Brazil. Even the modest reforms initiated by that country's new democratic government have paid large dividends. In 1985, Brazil had a balance-of-trade surplus of $11 billion and a real growth rate of 8%—double that of the U.S. As Mr. Wriston says: "Two years ago, they were saying the heads over Brazil . . . If you handle your affairs correctly, the capital of your own people will come back. If your own people don't trust you, why should anybody else?"

APPENDIX VI




The New York Times / April 20, 1986

APPENDIX VII

# American Food Exports Drop Sharply While Imports Rise

## Trade Surplus Is Forecast at $7 Billion, Worst Since '72

By KEITH SCHNEIDER
Special to The New York Times

WASHINGTON, April 19 — Global demand for United States farm products is dropping sharply, while Americans' taste for imported food is rising.

Farm products now make up less than 14 percent of the total value of all American exports, the lowest level since 1940, according to the Department of Commerce.

The value of farm exports from October through February dropped to $13.8 billion, 20 percent below the comparable period the year before, the Agriculture Department said. Department economists, who have already reduced their forecast of agricultural export sales for the year to $28 billion, say that they may have to lower it again next month.

In the same five months, American food imports totaled $5.6 billion, 6 percent ahead of the comparable period the year before. At the current pace, imports are likely to top $21 billion this year, a record, according to the Department of Agriculture.

The projected surplus of $7 billion in farm trade would be the lowest since 1972. The falloff, if it continues, will worsen the nation's overall merchandise trade deficit, which was a record $134.3 billion in 1985.

The drop in exports has come despite the fall in the value of the dollar, which should make American agricultural products more attractive to foreign buyers, and despite a new farm bill intended in part to spur exports. And it appears as nonfarm exports are on the rise.

The latest assessment by the Agriculture Department of the export situation, made Friday, came two days after it reported that the volume of American grain sold overseas in the five months ended Feb. 28 fell to 35 million metric tons, or 60.5 million standard tons, 16 percent lower than the year before.

"Corn, wheat, and cotton are way down," said Tom Warden, an economist with the Department of Agriculture. "Our forecast might have to come down another billion dollars. We're still looking at the figures."

Agricultural experts said Mr. Warden's assessment was a sharp reversal from the optimism that followed enactment in December of the Food Security Act of 1985. The legislation lowered the prices the Government set for most major commodities to help American farmers become more competitive and regain overseas markets they lost in recent years because of the high value of the dollar and the increasing ability of many nations to feed themselves. The law also contained new financing and subsidy programs that lawmakers said might lower barriers to trade.

### Estimates Are Lowered

Soon after the law's passage, the Department of Agriculture predicted that farm products' sales overseas would total $29 billion in the fiscal year 1986, a decline of $2 billion from 1985, which is relatively small when contrasted with the fall of $7 billion the year before.

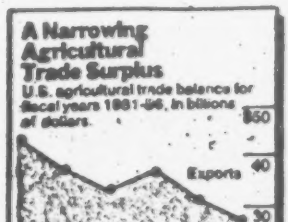
But in February, after reviewing dismal three-month trade figures, the Department of Agriculture reduced its export sales estimate, to $28 billion.

Agriculture specialists generally agree that the most significant changes in the new farm law have not taken full effect and that it may be too early to determine whether the law will help raise farm exports. They pointed out, too, that European nations, fearful of the lower prices for American products, are selling wheat and corn at record low prices, often with the aid of government subsidies.

"Anybody who has product is moving it out before our harvest hits the market," said Dennis Avery, an agriculture specialist with the State Department. "We now have a lower-value dollar. Our farm law has lowered prices to competitive levels. And once those combines start rolling through the wheat fields of Texas in May and June, I think we'll see that the United States is back in the game."

### A Long Road Back

But other experts said the world trade in food and fiber is more competitive than ever, and that it may be years, if ever, before American farmers return to the record level of 1981, when farmers exported a record 162 million metric tons worth $44 billion. The volume of exports has declined every year since, reaching 126 million metric tons last year. The latest forecast for 1986 is 122.5 million metric tons.




The New York Times / April 20, 1986

An ominous trend this year, they said, was the particularly poor sales of American farm products over the winter, traditionally a time of strong sales.

The reason for the turnaround in American food exports is a fundamental and extraordinary change in the old order of world trade in food and fibers that American farmers had dominated. Improved production practices and concerted efforts by governments to foster their own farmers have turned roughly 30 nations that were normally food importers into food exporters.

The world is awash in grain. Two hundred million metric tons are stored around the world, a record. In China, for example, corn production has expanded 15 percent since 1982, rice production has grown by 20 percent and wheat output is up 40 percent.

### A Crisis on American Farms

But the world's new ability to feed itself has spawned a crisis in the American Farm Belt. In 1981, the United States sold 68.2 million metric tons of wheat overseas, nearly 45 percent of total world sales. Last year, wheat growers managed to sell just 34.5 million metric tons overseas, about 28 percent of wheat sales worldwide. In the October-February period, American export wheat sales were down $1 billion from the year before.

"It's very bad," said Dick Fritz, a market analyst with U.S. Wheat Associates Inc., a Washington-based export trade association. "We don't see any improvement soon in this situation. Maybe the farm law will help. We could get back to the 50 million-ton level. I don't know if we'll ever get back to 68 million tons."

APPENDIX VIII

# Burma Shave

The Baker plan to urge market reforms in debtor countries is clearly a good idea, but its Achilles' heel is its reliance on "development" bankers to promote and monitor reforms. We've come across an especially revealing example of this problem at one of the World Bank's relatives, the Asian Development Bank, to which, coincidentally, U.S. officials in Manila last week committed $584 million more of taxpayers' money.

And what worthy causes does the ADB use this money to support? Among other things, the Burmese socialist party. Now, the most important thing to know about Burma is that its authoritarian socialist government has for decades run the kind of command economy in which smuggled cigarettes and Johnnie Walker Scotch pass for hard currency. If not for a booming black market, the place would collapse.

The ADB has nonetheless lent to Burma for years, and in this case proposed to lend $35 million to support "cooperatives" that make edible oil from such things as groundnuts. The proposal had doubters from the very beginning, because, as one ADB source tells us, "the numbers just didn't add up."

One egregious example is that the Burmese co-ops expect to sell the oil for about $1.80 per kilogram, while edible oil on the world market sells for 65 cents or so a kilogram. The Burmese will exclude the cheaper foreign stuff with tariffs and import controls. What's more, while the Burmese co-ops aren't formally state-owned, their board members have to be members of the ruling party in Burma, the Socialist Program Party. The co-ops also receive special access to state credit and other perks denied to private farmers.

Despite all of this, and despite opposing votes by the U.S. and Australia, ADB directors approved the loan in February. And there's more. An ADB analyst who visited Burma last year and opposed the project now complains he is being punished for an honest evaluation that bucked an ADB management desire to find some way—any way—to lend to Burma. The analyst, Peter Nelson, was excluded from the later ADB missions to Burma that eventually endorsed the project, and he was shifted out of the agriculture department.

ADB officials say Mr. Nelson was moved because of performance weaknesses and not because of his negative appraisal, though they decline to disclose the different appraisal documents. So we end up with this: Struggling farmers in Iowa are going to be taxed to subsidize a government-sanctioned project in a socialist country that usually opposes U.S. interests—and all to make a farm product that will cost Burmese consumers three times the world price!

Not every development loan falls into this believe-it-or-not category, of course, and in recent years the U.S., Britain and other countries have prodded the ADB to encourage private growth. They are beating their heads against entrenched interests. The main problem is that over the past 30 years both the World Bank and its sister banks have nurtured bureaucracies that care as much about self-preservation as about real development. Self-preservation often means making loans and more loans, whether or not they reinforce the kind of market policies that really create wealth. And market policies are the linchpin of the Baker plan.

If the Reagan administration ever hopes to win approval in Congress for more money for the World Bank (or for the $584 million it just pledged to the ADB), these institutions are going to have to change the fundamental way they do business. The lobbying effort won't survive many Burma shaves.

The Wall Street Journal
May 7, 1986

APPENDIX IX

DAVID FELIX

# *How to Resolve Latin America's Debt Crisis*

*Debtor countries should mobilize the huge foreign assets of their citizens and place a cap on interest payments as a percentage of their export earnings.*

The strategy adopted in 1982 by the major creditor countries to contain the Latin American Debt crisis is itself approaching crisis. After a euphoric interlude in 1984, when it appeared that Mexico and some of the other leading debtors were recovering their growth and debt-servicing capabilities, things are coming unstuck once again. Suggested alternative strategies to ease the payment burden of the debtors are again making the op-ed pages, while unilateral default proposals are rapidly gaining adherents in the debtor countries.

Most of the suggested alternatives fall into two groups. One group would have the governments of the creditor countries take over the LDC foreign bank debt, write off part of it, and distribute the loss between the lender banks and taxpayers. The proposals vary in their specifics, but these need not concern us here, since the fatal defect of all such proposals is not technical but political. They require legislation whose appeal to politicians and citizens of the creditor countries is unlikely to rise from level zero in time to meet the emerging crisis.

The second group would cap annual debt servicing by suspending amortization and limiting interest payments to some maximum percentage of the debtor country's export earnings, the unpaid interest being capitalized in new bank loans. Such proposals would seem to surmount the political barrier that blocks the first group. Like the current strategy, capping proposals, at least modest ones, can be implemented bureaucratically without the need for new legislation. As the crisis deepens, piecemeal action in that direction is likely—either unilateral setting of payment limits by hard-pressed debtors, or concessionary capping by the creditors to avert such unilateralism. But while mod-

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est, piecemeal interest-capping might be politically feasible, and could be a short-run crisis dampener, when tried on a major scale it would probably, as we try to show later, become merely a thinly disguised scheme for socializing and writing down the LDC loans, little different in substance from the direct debt write-down proposals. It would thus encounter the same sort of political resistance.

Both the current strategy and the alternatives are intended to eliminate the two interconnected components of the debt crisis. They seek to prevent the LDCs, mainly Latin American, who had been encouraged during the heady commercial bank lending boom of the 1970s to run up unmanageably large bank debts, from defaulting and setting off a cascading financial crisis in the major capitalist economies. Concurrently, they seek to nurse the debt-paying capability and bring the economic growth of the debtors back to pre-crisis vigor within a short-enough time to keep unilateral defaulting from becoming politically irresistible. But if the current strategy is coming apart, government debt takeovers and write-downs are political non-starters, and major interest capping is unworkable, what remains but to wait for unilateralism to pull down the house of cards?

Fortunately, there is an overlooked alternative that could overcome these difficulties. Blocked from view, probably by the dense ideological fog of our time, it could make interest capping economically workable by combining it with mobilization of the sizable private assets held abroad by citizens of the indebted countries. Capping plus mobilization, moreover, could be initiated independently by each of the debtor countries, requiring neither debtor cartels nor approval of the creditor cartel. The domestic politics of each debtor country rather than those of the major creditors would determine the political feasibility of the alternative for each country, although the strategy would also exploit the self-interest of the creditor banks to increase the technical feasibility of mobilizing the foreign assets. Successful implementation would enable debtors to free their economic policy making from subordination to the dictates of the IMF, while a longer-run side benefit could be a strengthening of defenses against future capital flight. A "free-lunch" solution? Not quite. There are costs, risks, and limitations, to be made clearer in our elaboration of the strategy. Before turning to this, however, we first complete the *mise-en-scène* by examining the flaws of the current strategy and of the interest-capping alternative in more detail.

## *Problems of the current debt-managing strategy*

The recent brouhaha set off by Vice-Chairman Preston Martin of the Federal Reserve Board, with his public plea for an altered debt management strategy to give more economic and political breathing space to the debtors, provides a useful window on the current strategy. For voicing it when growing doubts required reassuring hypocrisies rather than public candor from central bankers responsible for keeping the strategy afloat, Martin drew a spluttering dressing-down from Chairman Volcker. "I find his reported comments incomprehensible and unfortunately and unrealistically suggesting that there are unorthodox approaches to deal with the international debt problems," said Volcker. "What is hopeful and promising is that so many countries are coming to grips with necessary and difficult adjustment efforts. One example is the highly promising effort currently underway in Argentina."

The high disinformation content and uncollegiality of Volcker's statement suggest considerable nervousness. According to Fed officials quoted in *The Wall Street Journal*, he was expressing his irritation "that some politicians in Argentina, which has just announced a harsh new austerity program, interpreted the vice-chairman's comments as signaling a change in overall U.S. debt strategy." But in singling out Argentina's "highly promising effort" Volcker was clinging—surely in full knowledge—to a very thin reed. The new program is the third in 18 months extracted from the hard-pressed Argentine government by the IMF and creditors in return for a rollover of maturing debt and new loans to finance part of the interest bill. The first two efforts had foundered soon after adoption, and the new loans had been suspended. A similar denouement to the current program is widely expected. As the *Latin America Weekly Report* put it, "bankers have been saying quite openly that they do not expect it to 'hold' for more than a few months. In Buenos Aires, official sources told us this was a very real prospect, but that what mattered most was to get it signed, and so gain some respite from international pressures."

At issue is how much and for how long Argentina's economy can be squeezed without shattering it and/or the country's fragile democratic polity. Per-capita GDP had fallen over 13 percent, the annual volume of imports by over half, and the volume of investment by 24 percent between 1981 and 1983. Yet the new program was expected during its first year to depress GDP

by another 6 percent and to exact a major new cutback of public investment. Concurrently, the inflation rate had risen from low three digits in 1981 to low four digits in early 1985. Caught between a rock and a hard place, "the idea that a 'political solution' must be found to reduce crushing debt payments is heard more and more from top government officials, many of whom wouldn't have touched the topic two years ago," wrote Lynda Schuster in *The Wall Street Journal*. "One official says the country might, by the end of the year, tell the banks it is limiting debt payments to a small percentage of export earnings."

Also misleading is Volcker's attribution of orthodoxy to the current strategy. Far from being orthodox, it is unprecedented. If "orthodox" means conventional, some of the proposed alternatives pointed to by Vice-Chairman Martin better merit that accolade.

Never before have central banks and regulatory agencies of the major capital exporting countries allowed the international lending of their commercial banks to violate on such a grand scale four basic principles of orthodox banking: avoid gross mismatching between liability (deposits) and asset (loans) maturities; have ready resale markets for most of the loan paper; collateralize the loans with ample safety margins; and limit each borrower's loans to a small fraction of bank capital. As a result, never before in modern times have the interconnected financial systems of the capital-exporting countries been put so at risk by imprudent international lending. This is what gives the international debt crisis its unusual double facet.

In previous international debt crises, banks had been primarily brokers, underwriting foreign bond issues for resale to final holders: rentiers and nonbanking institutions. Mistakes and misbehavior in floating foreign securities had not threatened bank runs and financial chaos. The one important exception, the 1890 Baring crisis, was merely a partial one, set off when flagrant Argentine overborrowing in the 1880s caught Baring Bros., then the world's leading merchant bank, with a large inventory of unsold Argentine securities and a collapsing market for such paper. A run on deposits and acceptances by foreign holders ensued which threatened to exhaust Britain's gold reserves. The threat was averted by two sets of emergency measures engineered by the Bank of England and the Exchequer. One set successfully staunched the run on Baring by guaranteeing its liabilities. The second, built around the three-year loan to Argentina, helped keep up Argentina's foreign debt servicing long enough for Baring to liquidate its Argentine bond inventory. In 1893, with Baring's financial health restored, Argentina was allowed by a new joint agreement to postpone 30 percent of the interest and all amortization payments on its sterling debt for 5 and 8 years, respectively. For the British financial system, the crisis was over by 1893, though painful repercussions lingered on for British rentiers who had bought their foreign securities before the crisis and for the Argentine economy, which did not fully regain its growth momentum until the next decade.

Table 1 Debt and Balance-of-Payments Trends of the Larger Latin American Debtors in 1981–83

| | Percent change 1981 to 1983 (valued in current $) | | Change of foreign reserves to export ratios* 1981–83 | Debt-service to export ratios* | |
|---|---|---|---|---|---|
| | imports | exports | | 1983 values | Percent change 1981–83 |
| Argentina | −48 9 | −13 0 | −15 0 | 0 94 | +11 0 |
| Bolivia | −30 0 | −17 0 | +44 0 | 0 34 | +13 0 |
| Brazil | −30 2 | −8 0 | −12 0 | 0 66 | −7 0 |
| Chile | −56 7 | −3 0 | −15 0 | 0 62 | −23 0 |
| Ecuador | −34 6 | −10 0 | −41 0 | 0 30 | −17 0 |
| Mexico | −67 9 | +8 0 | −1 5 | 0 52 | +16 0 |
| Peru | −29 8 | −9 0 | −8 0 | 0 26 | −55 0 |
| Uruguay | −29 1 | −14 0 | −1 0 | 0 36 | +140 0 |

*merchandise exports

*Source*: Inter-American Development Bank, *Economic and Social Progress in Latin America*: 1984 Report (Washington, D.C., 1984). Appendix Tables 41-56 and country statistical profile tables.

Suspension of interest and amortization payments was the "orthodox," i.e., conventional, escape hatch of debtor countries in distress. After lags of varying duration—from a few months to four decades—agreements would be reached with creditors on terms for the resumption of debt service. Usually this involved lowering interest rates and/or writing off part of the accrued debt. Outright debt repudiation was rare. As rare were cases in which carrot-and-stick tactics similar to those used by the current creditor strategy sufficed to force badly overborrowed and economically depressed debtors to keep up full interest payments over extended periods of duress. So much for orthodoxy.

In Latin America's immediately preceding world-class debt crisis, that of the 1930s, fourteen of the countries suspended interest payments partially or in

full. This allowed the largest among them, following the collapse of their export-led growth in the 1929-1933 world depression, to finance the imports needed to regain economic momentum via augmented public-works programs and import-substituting industrialization. Refunding agreements with creditors were eventually reached in the late 1940s or early 1950s, but these involved debt writedowns of up to 80 percent, reduced interest rates, and extended maturities on the refunded debt. Understandably, nostalgic memories of the Golden Thirties now help nourish the growing Latin American default sentiment.

Going against the grain of history, the current strategy has been imposing the larger share of the adjustment burden on the debtor countries, without, thus far, achieving much by the way of structural adjustments. To see this we first take a look at Tables 1 to 3, which cover relevant economic trends in the larger troubled Latin American debtors, preparatory to analyzing the aborted 1984 turnaround. (Colombia and Venezuela are excluded from the tables. In 1983 Colombia's $19 billion foreign debt was still being serviced normally, helped no doubt by burgeoning drug exports. Its servicing problems have since worsened, but not to crisis proportions. Venezuela's $25 billion debt in 1983 required rolling over, but thus far this has been negotiated without IMF tutelage.)

Table 1 shows, that except for Mexico, improvements in the merchandise trade balance between 1981 and 1983 came entirely from drastic import declines that more than offset moderate falls in dollar earnings from exports. A secondary contribution to debt servicing was drawing down foreign exchange reserves, which all except Bolivia and Mexico did in varying degree. The ratio of debt service to exports rose nevertheless for half the countries in the table, even though all but Argentina and Bolivia had reached agreements with their official and commercial-bank creditors to defer part of their 1983 amortization.

Suppose all amortization had been postponed. Table 2 computes the annual interest bill on medium- and long-term debt in 1983 using a 10 percent interest rate. The calculation understates the actual interest bill, but conservatism in making one's point is no disgrace. Note that except for Mexico the surplus on current account excluding interest (column 3) fell far short of covering the interest bill (column 4). In other words, for most of the debtors a sizable share of their interest bill was paid with additional loans, including "involuntary" ones extracted from the creditor banks under the IMF debt agreements. Jacques de Larosiere, the managing director of the IMF, calls this "bailing in" rather than "bailing out" the banks. His oxymoron captures the novelty of the current debt-management strategy, which is directed at blocking debtors from disrupting the banking systems of the major creditor countries through unilateral suspensions of debt payments, using "involuntary" new loans by the already overexposed creditor banks for this purpose.

Table 3 illustrates some of the economic adjustment costs to the debtors as of 1983. The overall economic decline is too well known to require discussion. Less well known perhaps is the evidence in Table 3 that the decline of GDP since 1980 understates the drop of investment and consumption. The main reason is the drastic turnaround since 1981 in the balance of trade from deficit to surplus. The earlier deficits allowed the volume of locally produced goods available for consumption and investment to be supplemented by import surpluses. The recent trade surpluses, on the other hand, represent deductions from the domestic output available for local use. The most precipitous decline was in investment, but as the last column of Table 3 shows, the decline of consumption in most of the countries also exceeded the decline of GDP.

The clear implication of the three tables is that as of

Table 2 Other Debt-Servicing Indicators for the Larger American Debtors, 1983

| | External debt* | Annual interest bill at 10%* | Current account surplus, excluding interest | Ratio of surplus** to interest bill (3 ÷ 2) | Proportion of interest payable by 20% of exports |
|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) |
| | (Billions of U.S. dollars) | | | | |
| Argentina | 43.6 | 4.36 | 2.22 | 0.51 | 0.36 |
| Bolivia | 3.2 | 0.32 | 0.23 | 0.72 | 0.48 |
| Brazil | 91.2 | 9.12 | 2.84 | 0.31 | 0.48 |
| Chile | 17.8 | 1.78 | 0.62 | 0.35 | 0.43 |
| Ecuador | 5.3 | 0.53 | 0.01 | 0.02 | 0.86 |
| Mexico | 86.6 | 8.86 | 14.0 | 1.58 | 0.48 |
| Peru | 12.6 | 1.26 | 0.16 | 0.13 | 0.47 |
| Uruguay | 2.8 | 0.28 | 0.20 | 0.71 | 0.75 |

*Excludes short-term foreign debts.
**Excludes interest payments and receipts.

Source: Inter-American Development Bank, *op. cit.*, Appendix Table 42-48, Country Statistical Profiles.

the end of 1983 the limited improvements in debt servicing were due almost entirely to severe declines of aggregate effective demand and output in the debtor economies. If structural adjustments were also underway, the pace was meager, as evidenced by the massive decline of investment and the poor export performance. Also indicative of structural gridlock was the intensification of inflation and capital flight, fever blisters of sick economies in conflict. The weighted average inflation rate for the Latin American region accelerated from 54.0 percent in 1980 to 100.5 percent in 1983. Capital flight estimates are discussed below.

More recent country data for the array of countries in Tables 1 to 3 are not yet conveniently available, but regional weighted averages are. Some of these imply

Table 3 **Indicators of Adjustment Costs of Larger Latin American Debtors as of 1983**

| | Annual growth rates of GDP per capita in constant prices, 1961–80 | 1981–83 | 1983 gross investment in constant prices (1980 = 100) | Per capita consumption in constant prices (1980 = 100) 1980 | 1983 |
|---|---|---|---|---|---|
| Argentina | 1.8 | −4.5 | 63 | 135 | 116 |
| Bolivia | 2.0 | −8.2 | 33 | 159 | 122 |
| Brazil | 4.6 | −3.8 | 85 | 244 | 218 |
| Chile | 1.5 | −5.2 | 42 | 118 | 102 |
| Ecuador | 3.8 | −2.1 | 73 | 200 | 188 |
| Mexico | 3.5 | −1.7 | 63 | 196 | 187 |
| Peru | 1.9 | −5.0 | 76 | 161 | 137 |
| Uruguay | 1.7 | −5.0 | 49 | 102 | 89 |

Source: Inter-American Development Bank, *op. cit.* Table 1, p. 184, Appendix Tables 1, 4, 5.

that a significant turnaround had begun in 1984. These formed the basis for the light-at-the-end-of-the-tunnel euphoria of 1984. Other data, however, indicate the light was illusory.

On the positive side, GDP grew by 2.4 percent in 1984, sufficient to slow the decline of per-capita GDP to a negligible −0.1 percent. Leading the way was Mexico, whose GDP grew at close to 6 percent, enough to produce positive per-capita growth. Scattered data indicate the other major debtors did less well, though almost all managed at least to slow the decline of their per-capita GDP. There was also a significant expansion of the dollar value of exports: 8.5 percent for the region. Most of the increase was in export volume, but contributing also was an upturn of 1.2 percent in the terms of trade. The trade gains were evidently more evenly shared among the countries than the GDP improvement. Since imports of the region rose a meager 1.5 percent, the region's debt-service/export ratio declined by 4 percent despite a 4 percent rise in the region's foreign debt, and there was also a $10.5 billion increase of foreign exchange reserves.

Signaling the fragility of the 1984 turnaround, on the other hand, were an additional 7 percent drop of the investment/GDP ratio in 1984, scattered indications that open and disguised unemployment were still on the rise in most of the debtor countries, and the acceleration of the weighted average inflation rate of the region to 119.8 percent. The parallel 34 percent rise of the median inflation rate, which had declined in 1981–1983, also indicated that accelerating inflation was becoming more widespread. Capital flight persisted in 1984, while internal dollarization—i.e., the shift to the dollar as domestic unit of account and store of value—became more widespread in many of the debtor countries.

Moreover, the current evidence is that the 1984 improvements are being reversed. The dollar value of the region's exports has been declining since the summer of 1984, with the first quarter of 1985 14.6 percent below the 1984 first quarter. The deterioration parallels a decline of the dollar price of most primary exports since summer 1984 and worsening terms of trade for primary export-dependent economies. Almost all Latin American countries have shared in the decline, most notably Brazil with a 7.7 percent and Mexico with an 11.3 percent drop in exports. This fall and the preceding rise follow closely the phases of the current U.S. business cycle, validating the assumption, built into all the econometric models of the debt crisis, that Latin American export expansion is closely tied to the economic growth of the OECD countries, most notably of the United States. This is, however, sour news for the managers of the current debt-containment strategy, since the slowing of the U.S. economy seems likely to continue through the rest of 1985 at least.

Especially disconcerting has been the end of Mexico's recuperation. The 1983 agreement engineered by the IMF between Mexico and its creditors was heralded as path-breaking, "the model for dealing with debt-servicing difficulties in the future." Its twin novelties were long-term rescheduling—up to 14 years additional maturity—of half of Mexico's debt, and a modest reduction of the interest markup on the cost of funds applied to the rolled-over bank debt. In exchange for this plus $5 billion of new loans, Mexico was to pursue

IMF-approved policies and allow the IMF to monitor compliance. In financial circles the agreement was seen as a reward to Mexico for torpedoing Argentine efforts to organize a Latin American debtor cartel. The reward has proved too meager, however, to sustain a revival of the Mexican economy. With inflation and capital flight accelerating in 1985, the Mexican authorities have been forced once more to retrench, and now it is they who are pushing for a united bargaining front of the Latin American debtors while Argentina cold-shoulders the effort in hopes of reward from the creditors.

Divide and conquer tactics are thus still effective for the creditors, albeit at increasing cost in concessions. They are no defense, however, against individual action, such as that threatened by President-elect García of Peru, to limit interest payments to 10 percent of exports. Joint capping of interest payments is apparently also under discussion among Latin American officials, at least as a bargaining chip. A source familiar with the debtor conference hosted by Mexico in July informed a *Wall Street Journal* reporter that "the debtors soon will present a *fait accompli* to the industrialized nations. The debtor leverage . . . is simply ceasing [interest] payments."

## *Capping interest payments as an alternative*

Since the current strategy already finances unpaid interest with new loans, including "involuntary" ones from the commercial banks, limiting annual interest payments to a percentage of exports would seem to be merely formalizing existing practice. But that's misleading.

In the first place, the current strategy allows the creditors to keep debtors on a short leash. Rollovers of existing debt and capitalizing of unpaid interest are used as bargaining chips to induce debtors to adopt IMF-supervised economic programs that give top priority to strengthening debt-servicing capacity, as well as for extracting special favors, such as requiring debtor governments to guarantee ex post delinquent private-sector debts to the banks. Capping annual interest payments by formal long-term agreements would loosen the leash considerably, an unappealing prospect to the creditor banks.

Secondly, interest capping appeals to the debtors only if it frees substantially more export earnings for financing imports. For the Latin American debtors, this requires a low cap on interest payments and full deferment of amortization. Column 5 of Table 2 gives the fraction of the 1983 interest bill that each of the eight countries would have paid, if amortization were waived and interest payments were limited to 20 percent of 1983 exports. Adding interest due on short-term debt would lower the fractions by about 15 percent. Yet for four of the eight countries even the suitably reduced fractions of column 5 are *higher* than their debt-service/export ratios listed in column 4 of Table 1. One of the four is Peru, which explains why President-elect García threatens to invoke a cap of 10 percent of exports.

Thirdly, substantial interest capping would exacerbate the inconsistency between extracting new bank loans to keep the debtors in line and sanitizing the shaky loan portfolios of the banks. A piece of U.S. legislation that closes the barn door after the horse escaped, so to speak, the International Lending and Supervision Act of 1983, highlights the conflict. This act and the rising incidence of bank failures resulting from imprudent domestic lending have prodded bank regulators to restrict the use of "creative accounting" by U.S. banks to avoid writing down nonperforming loans, and to require them to raise their capital/loan ratios. However, writing down loans works against the last objective, as it lowers the numerator proportionately more than the denominator, while issuing new equity shares to raise the numerator is difficult these days, since the banks are viewed as risky investments. Expanding in safer areas that allow high interest spreads—consumer lending is the current honey pot for the banks—and diversifying into nonlending financial services are thus the preferred routes for improving the capital/loan ratio. This conflicts with the "involuntary" bank lending required by the current strategy. Indeed, another aspect of the emerging crisis for that strategy is the increasing resistance of U.S. and European banks with merely moderate holdings of Latin American loans to participate in new "bail-ins." Yet since interest capping is a *reculer pour meilleur sauter* strategy, it requires the banks initially to increase the flow of bail-in financing in order to provide the debtors with the resources to make the leap to normal debt-servicing capability. The longer the expected flight-time, the larger the cumulative increase of bank lending that will be needed, and the higher the resistance of the banks and the regulators to a major interest-capping strategy. Moreover, the leap could well fall short, causing bailing-in to degenerate into limitless Ponzi financing.

Fortunately, we don't have to choose here among

the scenarios. Collectively they suffice to reinforce the basic message that broad-scale interest capping is a high-risk alternative to the current strategy hence unappealing to the creditors. This is all that's needed to complete the mise-en-scène for bringing on stage our less-risky alternative: interest capping with reliance on the mobilization of foreign assets of the debtors rather than on bailing-in loans.

## *Combining capping with mobilization of foreign assets*

How large are the foreign asset holdings of the various Latin American debtors? According to a recent Banco de Mexico study, capital flight totalled $33.2 billion between 1977 and 1984—four-fifths of the outflow occurred during 1978–1982, when it averaged 48 percent of the gross inflow of capital to Mexico. The outflow was $3.7 billion in 1983 and $2.5 billion in 1984, when it totalled 52 percent of the increment to the foreign debt, and news reports indicate that the pace of Mexican capital flight picked up in 1985. Add the pre-1977 outflows, capital appreciation of the assets, and the current value of foreign assets of Mexican nationals is probably not far short of the $100 billion Mexican foreign debt.

The ratios of Argentina and Venezuela are even higher. During 1978–1982, according to World Bank estimates, Argentine capital flight was 65 percent of gross capital inflow and Venezuela's an astonishing 137 percent. The estimated ratio was a more moderate 27 percent for Uruguay, and a modest 8 percent for Brazil. Chile's ratio is probably in the moderate group and Peru's is in the high group. Since Latin American capital outflows tend to move through clandestine channels, all estimates are, of course, merely rough approximations of reality, give or take a few billion.

Still, we're talking about a very sizable potential resource for many of the debtor economies. A recent *Wall Street Journal* editorial, citing unidentified experts, put foreign liquid assets of the four largest Latin American debtors at $100 billion. Add the liquid assets of the other debtors, Latino ownership of Sunbelt and European real estate, and the $15.5 billion direct investment of Latin American firms in the United States reported by the U.S. Department of Commerce, and we're around $180 billion, or half the region's current foreign debt. Aside from the Philippines and one or two of the African kleptocracies, none of the LDC debtors of other regions comes close to the high Latin American ratios of foreign assets to debt.

Yet, while interest in measuring capital flight has increased, it has not sparked proposals to use foreign holdings to alleviate the debt crisis. Mainstream economists with their relative price nostrums for all societal ills are, of course, an unlikely source of such suggestions. They blame capital flight on overvalued exchanges and low real interest rates in the debtor economies, downplaying the importance of other motives, such as tottering banking systems, depressed business prospects, political unrest, and money laundering of illegal earnings from drugs, corruption, tax evasion, and the like. Latin American policy technocrats applying relative price solutions to capital flight have, however, discovered through sad experience, that devaluing plus raising domestic real interest rates will in the current Latin American context encourage the other motives for capital flight by exacerbating bankruptcy, financial instability, and the downward slide of production. Mexican capital flight, for example, was greater in 1983, when the peso was notably undervalued and real interest rates were high but output was falling, than in 1984 when the opposite conditions prevailed. Oddly, while such experiences have reinforced the demands of heterodox Latin American economists for payment capping, it has not awakened them to the possibility of mobilizing outstanding foreign assets to alleviate the debt. (The recent Havana conference on the debt is a case in point. Speakers bemoaned the burden of the debt, called for write-downs or partial repudiation, but apparently completely ignored the foreign asset mobilization possibility.)

Can the privately owned foreign assets be mobilized for debt servicing? Let's first dispose of a spurious theological objection. To do so would not be to administer a death blow to capitalist property rights. Coercive mobilization even has a slight patina of orthodoxy; it was used in the past by major capitalist countries in duress. During World War I, Britain and France, the two leading international lenders of the laissez-faire era, compelled their nationals to register their foreign securities with the Treasury, which liquidated them as needed, paying the owners in local currency bonds, the foreign exchange being used to help cover current account deficits (see For Further Reading). As the Chancellor of the Exchequer put it to Parliament, "The government wanted to get these securities, as far as possible, into one hand, so that they might be controlled and used for the purpose of paying our debts in the United States. They believed that these securities would afford us a very great resource which would be fully sufficient to meet our liabilities."

With the World War I experience in mind, the Tory government on the eve of World War II took the precaution of requiring registration of all foreign securities with the Treasury, which could sell them as needed, and did (see For Further Reading). The term "War Economy" is currently in vogue as a metaphor among Latin American politicians trying to rally support for the wage and budget cuts of their IMF-sanctioned programs. They should be advised that the mobilization of private foreign assets has also been part of the war economy of capitalist countries. Were they to attempt it, they should also find their banker creditors, who have been busily pressing the debtor governments to take responsibility for privately contracted foreign debts, flexible on property rights issues. As a foreign banker operating in Argentina recently put it to a reporter of *The Wall Street Journal*," We foreign bankers are for the free-market system when we are out to make a buck and believe in the state when we are about to lose a buck. This thing will come down to a matter of muscle."

A more valid concern is that few Latin Americans with assets squirreled abroad, much of it illicitly, are likely to register them merely because a new law required it. Fortunately the problem has a potential solution: the collaboration of the creditor banks in tracking down the overseas assets.

Three elements need to be brought together to effect that collaboration. By serendipidity, one of the elements is already in place in the dominant safe-haven for flight capital, the United States. Under the Bank Secrecy Act of 1970, all U.S. financial institutions—banks, brokerage houses, etc.—must file ownership information on each foreign or domestic cash transaction of over $10,000 with the IRS. Recently, the Reagan Administration introduced a bill to increase penalties for noncompliance that appears to have widespread Congressional support. The objective of all this has been to reduce tax evasion and to trace laundered money of drug and crime syndicates. But it also means that financial institutions have for fifteen years collected information on flows in and out of individual-deposit, investment-fund, and brokerage accounts of foreigners, including outflows to other safe-haven countries. For tracing real-estate ownership, public records of transactions have, of course, long been available.

The other two elements provide the stick and carrot the debtors would need to induce the collaboration of the creditor banks. The stick is unilateral capping of annual interest payments out of export earnings. The carrot is the simultaneous announcement that the foreign assets of each national above a minimum (perhaps $10,000) must be exchanged for local currency bonds, the foreign assets so obtained to be deposited in a U.S. escrow account for the sole use of paying the residual annual interest bill. The account would offer the banks the double prospect of avoiding new bailing-in lending and of belatedly collateralizing their existing Latin American loans, strong inducements for working with the debtor governments in tracking down foreign assets to build up the accounts. Initial tracking successes could also raise the level of voluntary compliance, particularly if the asset-exchange terms provide premia for early registration.

The specifics, such as the yields and liquidation schedules for the local currency bonds, would have to be tailored to the different economic conditions of each of the debtors, but all those with large foreign asset-to-debt ratios could reap major benefits. Foreign-asset mobilization would distribute the burden of adjustment to the debt crisis over the rich and the poor more equitably than the IMF-imposed programs. The freeing of more export earnings for importing, and the elevating of the transactions costs of new capital flight, would make the pursuit of more aggressive recovery programs feasible. And servicing debts with their own resources rather than with beggars' bowls might, in addition to rebuilding national morale, restore earlier access of the debtors to foreign capital markets by demonstrating an unexpected but welcome capacity to service their debts from their own resources.

Is all this politically feasible? *¿Quién sabe*? As a class the Latin American wealthy have not shown themselves to be well-endowed with *noblesse oblige*. In major societal crises of the past, however, the elites of some of the Latin American countries have demonstrated flexibility. Quiet encouragement, or at the least benign neutrality by the creditor governments would, of course, help tip the balance favorably.

Why should they want to be encouraging? Two obvious reasons are their geopolitical interest in the economic and political health of the region and the desire to strengthen the balance sheets of their shaky banks. More controversial is the argument that making their financial markets less secure for flight capital is also an economic plus for them. That is, weakening the dominance of skittish international financial flows over the exchanges would strengthen the exchange rate as a governor of real trade and capital flows. The ultimate reason is, however, that the alternative strategies for resolving the Latin American debt crisis look worse.

Senator SYMMS. Thank you for a very excellent statement and presentation and I will do my best to see that it gets further coverage in the Senate so that more Senators will be aware of the points that I think you make so well.

Congressman Craig, do you have any questions?

Representative CRIAG. Not at this time, Mr. Chairman.

Senator SYMMS. I might just ask one question with respect to exchange rates that I would be interested in.

In your opinion, should we continue with the floating exchange rates and try to have a cleaner float of most currencies in the world or should there be some effort made to restore convertibility to the dollar and other currencies on a fixed exchange rate with gold?

Mr. RUFF. Well, there are good arguments on each side, but generally speaking, I like the floating exchange rates for one important reason. They reflect realities between countries and their policies and the soundness of their currencies.

For example, we had a falling dollar vis-a-vis the Japanese yen. The yen is reaching new highs versus the dollar. I think that reflects ultimately the perceived soundness of the currency. Now we went through a strong economic expansion and the dollar was strong against everybody else. It was overdone, of course, but ultimately, in the long run, when the whole wash is out and all is said and done, I think it reflects reality, and I think trying to influence those exchange rates by artificial pegging of rates which reflect political reality but not necessarily economic reality distorts the free speech of the market which tells us when there is something wrong.

I would like to make two other comments that were attributed by previous testimony if I might. First, I am a financial adviser but I live in a farm community and I farm ten acres and sell a little hay. I am also a partner in a sheep breeding business with my son-in-law that employs ten very hard-working rams and so I do understand, because of the town in which I live and the people that my kids go to school with and the people that I work with and my own family, the problems of the American farmer.

There are a lot of farmers out there that are paying the price of their own profligacy. In other words, as was said earlier, they did go out and buy $200,000 combines with air conditioning and stereo and they did borrow money at 21.5% to buy land to expand assuming inflation would continue. Those are the ones that are basically in trouble because of their own profligacy.

But now there are distortions in the economy created by such things as these policies we've described today that are getting to and hurting even the conservative farmer who ran his business well, who was prudent, who did not overextend himself. And I don't have a lot of sympathy for those people who out of greed thought that inflation was going to go to the sky and they were going to make a fortune on farming based on artificial external economic forces, but now I think we have to take those steps without interfering with the world economy and without becoming protectionists, without starting trade wars, which can make life easier for that farmer in a competitive free market where he has a level playing field.

Senator SYMMS. Thank you very much.

Mr. RUFF. Thank you, Senator.

Senator SYMMS. Congressman Craig.

Representative CRAIG. Mr. Ruff, let me thank you very much for your testimony and, Mr. Chairman, let me thank you for participating from this side of the bench in this hearing.

I have one question that has developed in my mind as it relates to—let's use the example of the Mexican steel mill. Was that Mexico?

Mr. RUFF. Brazil.

Representative CRAIG. The Brazilian steel mill and it obviously was built to identify with markets outside the country of Brazil. Those kinds of concerns—increased copper production in Chile, general agricultural increases as a result of this stimulus that's gone on through the international banking system—we are now beginning in the House to look at trade policy adjustment, better known as a new trade bill.

Some of it has some "protectionary" style to it. Some of it does not.

How do you react to a situation where you get countries who, by the urging of IMF, constantly move to increase production, to convert cash flow to service loans, into a glutted market, and a lot of that production geared for this huge consuming U.S. market; and our government then, through a change in trade policy, starting to back away from, if you will, the open door. We call it free trade. There are some of us, and I'm included, who have put a new word with "free" and that's "fair," and that becomes a question of subsidy, whether it be from the domestic government that's the primary importer or from multinational institutions.

You speak of the house of cards, the financial world's house of cards, and that card structure for any sense of stability currently, under the way it's structured, must continually feed itself and flow its product outward to maintain any sense of stability.

If we put check dams ever so subtle in the flow, what happens?

Mr. RUFF. Well, I think to subsidize foreign countries to produce and then to come up with protectionist provisions, no matter how disguised they might be, to prevent the sale of the exports that we subsidized the production of is sort of like driving a car with your foot on the accelerator and your foot on the brake at the same time. You may get where you're going but it's going to do terrible damage to the car in the process.

My concern is that free markets in the long run, with all of their distortions and all the messiness that goes on in the free markets, free markets in the long run service us all best. But it's been truly said that for every person flinging away at the leaves of the problem, for every thousand people doing that, there's one attacking the roots, and the roots of this problem are not in the fact that they are producing cheaply and selling in this country and so we have to take steps to protect ourselves. That's not the root of the problem.

The root of the problem is that these countries are being required to maintain the fiction of sounds for the benefit of the bankers so they don't have to write off these bills servicing these debts they shouldn't have to service.

Now I'm not saying that people in this world should get off scott free as a matter of principle, but as a matter of another principle, if someone can't pay his debt—the United States law provides that if you can't pay your debt you can file bankruptcy and start over again. Now that's not a very nice thing to do but nevertheless it faces reality and it deals with it.

Our proposal at the end of our testimony was that we would require that there be independent evaluation of bank portfolios and if they've got loans to Mexico to determine how much Mexico can truly service, for example, and that they would be required to service and the rest of the loans be written off over a ten-year period so the bank doesn't have to take a big earnings hit right now, and the country no longer has to have trade flows to renew the debts that are never going to be paid anyway which only makes the problem worse. It faces reality and stops the process right here and now.

Now if you do that and you're not subsidizing production in this country and you lift the huge debt burden off the back of those people in those countries, several things happen. For one thing, you aren't giving them money which can flow out in the capital flight which we described before; and the second thing that's happening is that those countries can get about the business of building their own economies through the workings of their own country. So you get the debt service burden off the backs of those people. The banks would have to take an earnings hit, but not all at once so it wouldn't devastate their balance sheets and force them to close over a period of time.

Anything else that you do to try to interfere with the flow of markets, as I said, is stomping on the accelerator with loans and putting on the brakes with protectionist policies. You don't have to do that any more. You have removed the reasons for most of those actions.

Representative CRAIG. One of the suggestions that you made that intrigued me because I've been looking at ways to say, through the current system, "Okay, bank, if you wish to go plunging into a foreign country and make high-risk loans and endanger your financial stability in this country and your own structure, somehow you have to pay a little bit for that."

Some of us have argued, well, you could say through the current federal law and regulation that a bank could only invest a certain percentage of its portfolio outside the continental United States, and yet I don't like that kind of restrictive game.

Mr. RUFF. Nor do I.

Representative CRAIG. The FDIC charge that I think you mentioned is a fascinating tool. If you're going to play a high-stakes game, if you're going to roll at the table with the dice of the international market, you pay the margin that it would take to insure the high risk of that game you play.

Mr. RUFF. Absolutely. That's one of the reasons why we are preparing substantially—not just a little bit—but substantially higher premiums for banks that have been profligate with their lending policies.

But you see, bank accounting under present law, creates a facade of stability that does not exist. Now as a stock market adviser, I look at my charts and they tell me that for the last year's stocks,

and especially the New York banks, have been a bull market. They have been in an uptrend. And the conclusions investors are drawing about the soundness of those banks where they invest in the stocks and drive the price up is based upon fallacious accounting permitted under present law.

It's a very simply this. If you've got a bad loan you can loan some more money to the borrower and he can make his interest payments and a bad loan becomes a good loan.

Senator SYMMS. In other words, you're saying that their portfolios carry loans that aren't really worth what the portfolio says?

Mr. RUFF. Does anyone in this room truly believe that Mexico is going to pay back $100 billion of loans? No. And you ask any banker on the face of the planet if they truly believed that principal would be repaid. Now Walter Wriston, when he was chairman of the Citibank, made a statement, he said, "Sovereign nations don't default on their loans," and that was widely quoted. But then he went on to say, "Besides, we don't ask them to pay back their principal. All we're concerned with is can they service their debt. If they ever paid back the principal we would just have to find someone to loan it to anyway." So that's the way the international game is played. It's played on the assumption that that principal will never be paid.

I'd like to find a banker like that who would like to do business with me.

Senator SYMMS. You've probably read the recent study by the Heritage Foundation. Mr. Mittendorf gave it to me about a month or so ago—of the history of Latin American bank defaults, and they have literally made a cottage industry out of defaulting in the last century. Yet we're back to the same place again.

I would just repeat again the former Secretary of Treasury's quote, "When fear comes in, reason departs, and piling debt upon debt cannot ultimately succeed and the day of reckoning extracts a high price. By extending credit to countries beyond their ability to repay, the final bankruptcy is worse." William Simon, our former Secretary of the Treasury said that. I think that's where it looks to me like we're headed with these Latin American loans.

Mr. RUFF. I would like to make a forecast now if I might and go firmly on record. If we continue to keep that ball in the air by continuing to cover up bad loans with new loans so that interest payments can be made, we are eventually going to reach the point where the Federal Reserve is going to have to choose between two things. One is going to be to let them default and let the system come down, or print unlimited sums of money to deal with the liquidity problems of the banks. And not only as those lenders say they can't pay, but as the depositors begin to catch on to this game and say, "I don't think I want my money in that bank." And ultimately the decision will be made to inflate the currency, to print whatever money is necessary, to ship it in C-132s if they have to, to banks all over the country to meet withdrawal demands, and the end result of these continuing policies will be a ruinous inflation. And I say this at a time when everybody seems to believe that inflation is dead forever. It is not. It is just sleeping.

Senator SYMMS. Well, one of the things that concerns me—Congressman Craig mentioned we had the Valley bank close in Idaho

this last week with six branch offices. The thing that I fear is that if you have a default in Mexico or Brazil where they make a major default, then our Federal Reserve under current law has the ability to go in and buy up those loans the second that happens if they choose to do that, which they have the authority and the power to do it given to them by the Congress in 1980, that they can buy those loans and put them in the Federal Reserve System, that means that the U.S. farmer in Oklahoma or Idaho or Utah or Kansas is competing against the defaulting countries in Central America. The way I see it, you'll have a terrible schism in the country of competition—the appearance anyway of competition between U.S. farmers and defaulted loans in Latin America, and I think that could create a terrible problem in the country that would be very difficult.

Mr. RUFF. Well, if you would like a piece of irony to pile on top of that, Senator, not only are they being asked with their taxes to subsidize their competition, but the Federal Reserve is buying up foreign debt, which it was given the power to do in the Monetary Control Act of 1980—when the Federal Reserve prints money or orders money to be printed and buys up forign currency, it used to be that we couldn't print money except when it was backed by gold and then we could print money to buy up U.S. Treasury securities, but under the Monetary Control Act of 1980 they can buy up foreign currencies which means that your money which used to be backed by gold and then backed by U.S. Treasury securities is now partially backed by the Mexican peso and foreign currencies. That doesn't seem too swift in terms of stabilizing the dollar. This policy of hurting ourselves with our own actions applies, for example, to loans to communist countries. The Soviet Union and Eastern bloc countries have borrowed about $80 billion from western banks. Now that money is used, of course, to help subsidize their military buildup. Then we run huge deficits and spend equivalent amounts of money or perhaps even more to catch up with the buildup we helped finance, and on top of that, the loans from the western banks are so big that if the Soviet Union defaulted it could bring down our economic system. So we now have a vested interest to keep the economic system from falling apart and preventing the collapse of international communism. And this is the kind of rationale we have been doing, not just for the Russians but also for the farmer.

Senator SYMMS. Thank you very much.

The subcommittee is adjourned.

[Whereupon, at 12:10 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

STATEMENT OF HON. BILL EMERSON, A U.S. REPRESENTATIVE IN CONGRESS FROM THE EIGHTH CONGRESSIONAL DISTRICT OF THE STATE OF MISSOURI

Mr. Chairman, as a cosponsor of H.R. 3643, I want to take this opportunity to reaffirm my support for it. I believe it is extremely important legislation and worthy of passage in the Congress this year.

The International Monetary Fund and a number of other multilateral lending institutions give low-interest loans with favorable terms to many foreign countries. Since the U.S. contributes about 20% of the IMF's budget and a similar percentage to other institutions, we are in effect subsidizing foreign producers who compete directly with our own farmers--and there is no doubt that our farmers are paying the price for this. In the past four years, the U.S. share of the world soybean market has dropped a whopping 10%. Our share of the world wheat and wheat-flour market fell from 39% in 1978 to 36% in 1984. U. S. exports of course grains have dropped from 61% to 56 percent as a share of world markets in the past five years. Rice has gone from 21% to 18%.

With the help of these loans, many borrower countries are becoming agriculturally self-sufficient and are exporting their farm products to the U.S. at lower subsidized prices made possible by the loans. The intent of these loans is to repair damaged economies, but in the process of doing that, they have damaged our own farm economy. The U.S. is the country most hurt by this lending. Not only do we lose our overseas markets, but we gain new domestic competitors that our own country is helping to subsidize.

It is high time we take some action to correct this and I was encouraged when language was added to the Senate-passed farm bill which would require the U.S. representatives to the I.M.F. and other institutions to vote against loan requests that would lead to the displacement of American agricultural exports. If the loans were approved anyway, the U.S. would then withhold a corresponding amount of funding from the institution. Unfortunately, the language was "watered down" in the conference committee so that now only a study of the problem is required. Now, H.R. 3643 has been introduced by Congressman Boulter which accomplishes a similar objective as the original Senate language. At a time when our budget deficit is burgeoning and our farm economy is sagging, it is beyond me to know why we should be spending taxpayers' money to drum up new competition for our own farmers. It is my hope that these hearings will impress upon the members of the Joint Economic Committee the wisdom of this bill.

Written Testimony for the Record
James W. Conrow, DAS for Developing Nations
Before The Joint Economic Subcommittee
on Monetary and Fiscal Policy

May 13, 1986

U.S. Policy on MDB Loans for Agriculture

Historically, between 20 and 25 percent of annual lending by the multilateral development banks (MDBs) goes for agriculture. Most of the assistance has been aimed at helping small subsistance farmers modernize and develop cash crops for local markets; increase income and employment in the respective countries; and lower food prices. Most agricultural projects are relatively small - $40 to $75 million - and they take 5 to 7 years to implement.

MDB projects for agriculture include financing a wide variety of complimentary activities, although not all of them are included in each project. For example, individual projects may include settlement or improvement of land; development and use of irrigation; research to develop a technological package and extension services to disseminate it; supply of inputs (seeds, fertilizers, pesticides); credit for purchasing seasonal inputs or for equipment and other long term investments; facilities for storage, processing, and marketing; rural roads, potable water, and electricity; and, technical assistance to strengthen the relevant institutions.

For example, approximately 15 to 20 percent of the funds are channelled through financial intermediaries for credit and another 20 percent is for direct inputs, particularly fertilizer. Another 5 percent is research and extension.

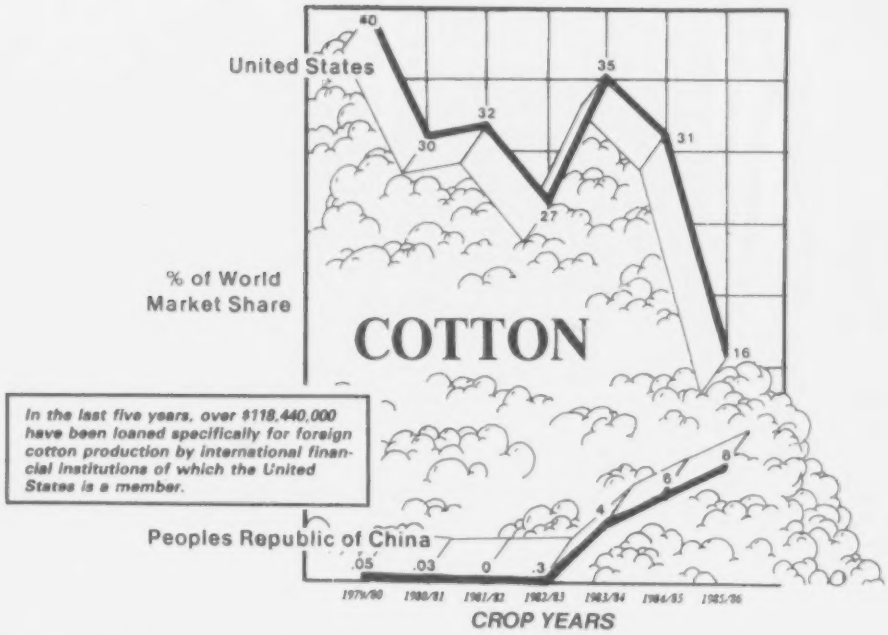
Some of these agricultural projects, such as those supporting the production of tobacco and other non-food crops, have been controversial. Where such projects violate the standards and criteria established by Congress, U.S. Executive Directors are instructed to oppose the loans. In addition, they have standing instructions to make their respective banks aware of U.S. concerns about these types of loans.

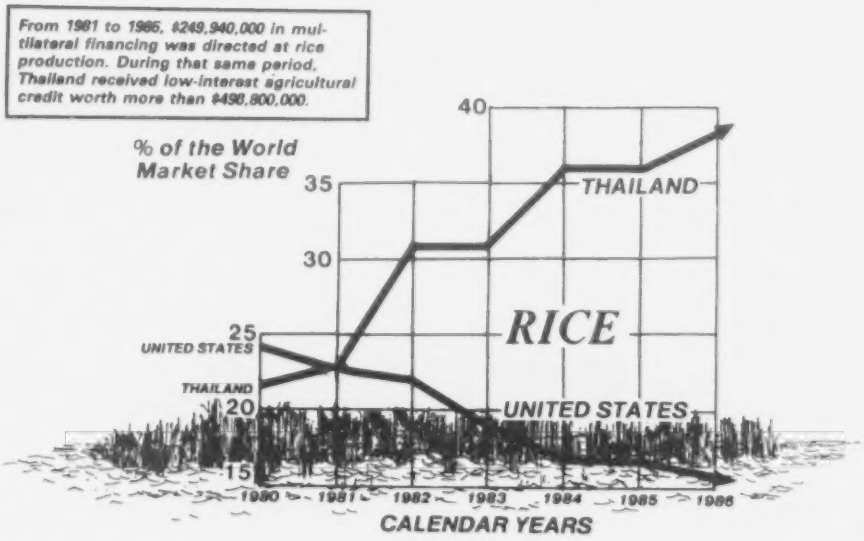
Questions and concerns, however, have recently arisen with regard to policy based agricultural sector loans. The purpose of these loans is to encourage and support necessary economic policy reforms to promote sustained growth in borrowing countries. Specific reforms sought include reducing inefficient resource use, the lowering of trade barriers, increasing domestic savings, and the removal of unfair trade practices such as subsidies. If adequate reforms are not attached to these loans, the U.S. government will oppose them.

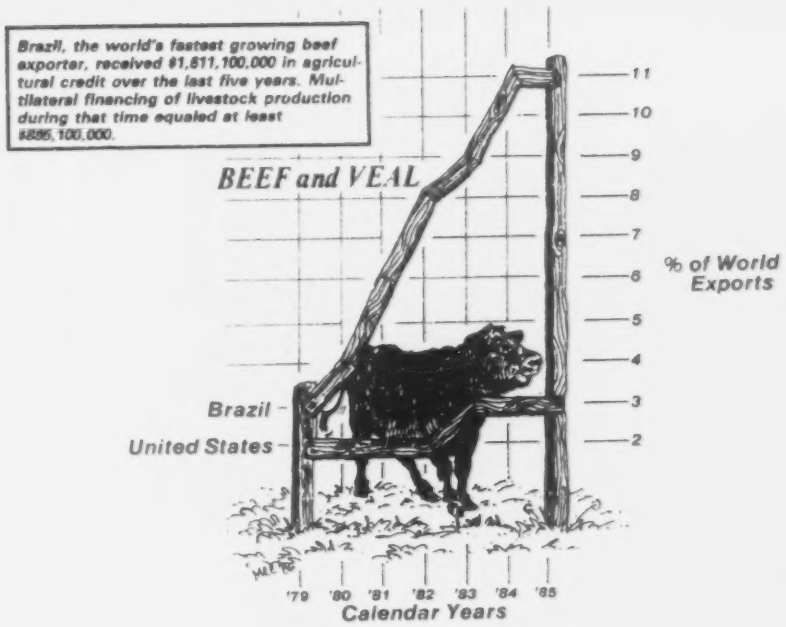
Unfortunately, the perception of these relatively sizeable sector loans, drawn largely from the recent IBRD agricultural sector loan to Argentina, is that they are aimed primarily at promoting agricultural production and/or "bailing out the commercial banks at the expense of U.S. farmers". This is clearly not their primary objective even though in the Argentine loan the principal reform -- reductions in export taxes -- may encourage more competitive production.

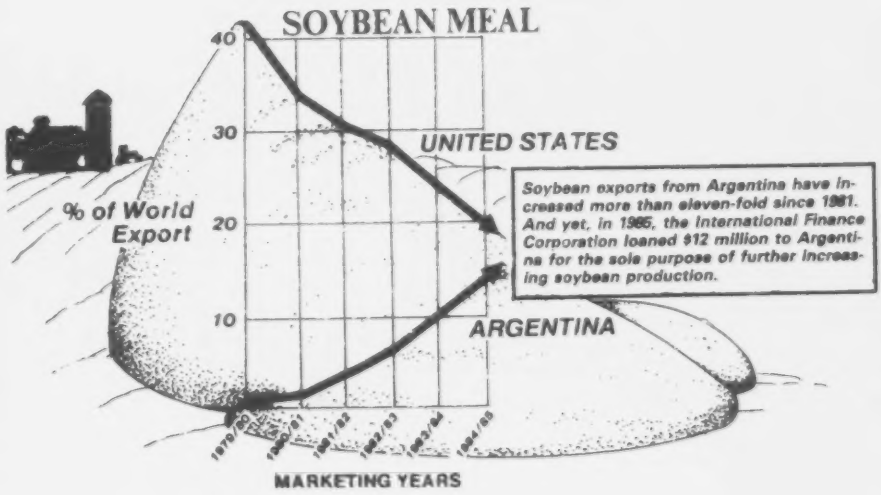
The primary thrust is to achieve policy reforms needed for economic growth. It is our view that the developing countries will be only able to solve their economic problems, including their external debt service, by enacting policy reforms such as those listed above. In addition, we believe it is in our interests to support such lending. It will open up LDC markets (which account for approximately one-third of our exports) to U.S. exports, including agricultural exports, by reducing or removing unfair trade practices; and, by increasing the income, foreign exchange earnings and employment in these countries will expand their markets.

In those few instances where policy based loans will result in competition with U.S. producers and there is a conflict in U.S. objectives, we will press the banks to find alternative ways to solve the problem as we have done in the past.

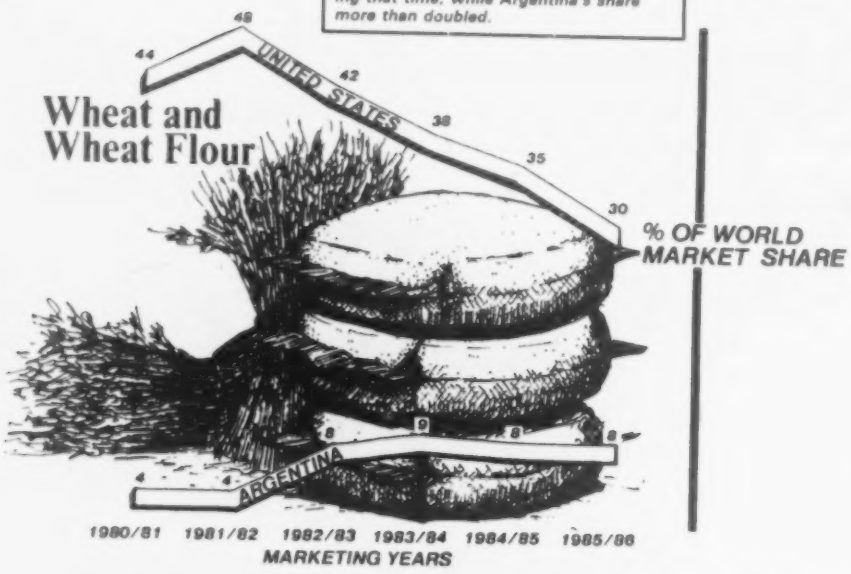

United States
40
30
32
27
35
31
16
% of World
Market Share
COTTON
In the last five years, over $118,440,000 have been loaned specifically for foreign cotton production by international financial institutions of which the United States is a member.
Peoples Republic of China
.05
.03
0
.3
4
6
8
CROP YEARS


From 1981 to 1985, $249,940,000 in multilateral financing was directed at rice production. During that same period, Thailand received low-interest agricultural credit worth more than $498,800,000.
% of the World
Market Share
40
35
30
25
20
15
THAILAND
RICE
UNITED STATES
UNITED STATES
THAILAND
1980
1981
1982
1983
1984
1985
1986
CALENDAR YEARS


Brazil, the world's fastest growing beef exporter, received $1,811,100,000 in agricultural credit over the last five years. Multilateral financing of livestock production during that time equaled at least $855,100,000.
BEEF and VEAL
% of World Exports
11
10
9
8
7
6
5
4
3
2
Brazil
United States
'79
'80
'81
'82
'83
'84
'85
Calendar Years


SOYBEAN MEAL
40
30
20
10
% of World Export
UNITED STATES
ARGENTINA
Soybean exports from Argentina have increased more than eleven-fold since 1961. And yet, in 1985, the International Finance Corporation loaned $12 million to Argentina for the sole purpose of further increasing soybean production.
1979/80
1980/81
1981/82
1982/83
1983/84
1984/85
MARKETING YEARS

*Argentina, the world's fourth largest wheat exporter, received multilateral farm credit totaling more than $111 million during the last five years. The U.S. share of the world wheat market declined 32% during that time, while Argentina's share more than doubled.*




A Private Farm Marketing and Management Service from Doane Publishing

March 21, 1986

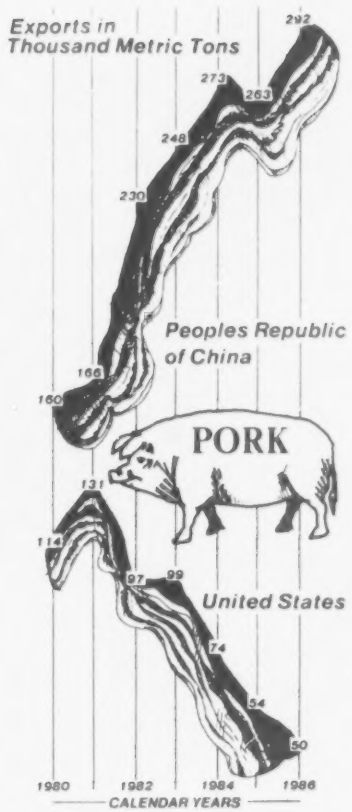
# Doane's Agricultural Report.

## MARKETRAK

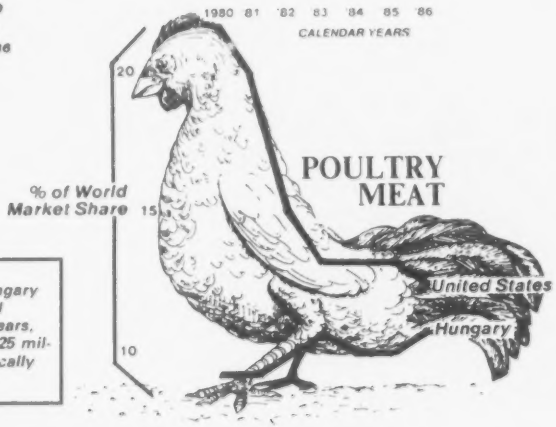
| | This week* | Last week | Year ago |
|---|---|---|---|
| Corn, no. 2 yellow Central Ill., bu | $ 2.21 | $ 2.20 | $ 2.70 |
| Sorghum, no. 2 Kansas City, cwt | 3.88 | 3.83 | 4.08 |
| Barley, no. 2 feed Minneapolis, bu | no quote | no quote | 3.00 |
| Oats, no. 2 heavy Minneapolis, bu | 1.32 | 1.29 | 1.79 |
| Soybeans, no. 1 yellow Central Ill., bu | 5.32 | 5.33 | 5.80 |
| Soybean meal, 44% Decatur, ton | 164.50 | 162.50 | 156.00 |
| Wheat, no. 1 hard Kansas City, bu | 3.48 | 3.39 | 3.66 |
| Wheat, DNS, 14% Minneapolis, bu | | | |
| Wheat, no. 1 White Portland, bu | | | |
| Cotton, 1 | | | |

## Up Front

**Effects of lower '86 U.S. commodity loan rates** are beginning. Argentina plans to shift away from taxing grain exports in favor of land taxation. Taxes on grain exports are the major source of hard currency for Argentina. Those export levies were relatively painless when world grain prices were supported by high U.S. loan rates. But the shift to lower loan rates means Argentina may have to scramble for a new source of revenue if it is to remain competitive in world grain markets. Ironically, the World Bank, with U.S. support, is considering a loan to compensate for the loss of revenue during the transition.




*Since 1981, multilateral banks have loaned more than $420 million to the People's Republic of China for agricultural development. While China's pork exports have nearly doubled, projections for 1986 show the U.S. share of the world pork market reduced to only a fourth of what it was in 1981.*




*In 1985, the World Bank loaned Hungary $80 million specifically for meat and poultry exports. In the past three years, Hungary has received more than $125 million in multilateral financing specifically for agricultural development.*

## AFTERNOON SESSION

The Subcommittee on Agriculture and Transportation met, pursuant to notice, at 2 p.m., in room SD–G50, Dirksen Senate Office Building, Hon. James Abdnor (chairman of the subcommittee) presiding.

Present: Senators Abdnor and Mattingly.

Also present: Joe Cobb, Dale Jahr, Kenneth Brown, Jim Pasero, and Don Terry, professional staff members.

### OPENING STATEMENT OF SENATOR ABDNOR, CHAIRMAN

Senator ABDNOR. The Subcommittee on Agriculture and Transportation of the Joint Economic Committee will be in order.

I just want to welcome our witnesses today to the subcommittee hearing on subsidizing foreign agriculture. Too often, well-intentioned government policies when put into effect turn out to create more problems than they solve and this is certainly one of those cases. For years, multilateral lending institutions, specifically the World Bank and IMF, have attempted to provide developing countries with low interest credit for the purpose of helping the borrowing nations expand their economic productivity. Sometimes these loans have been successful. Sometimes they have not.

As my record indicates, I have never been in favor of foreign aid nor am I a proponent of multilateral lending institutions. And now when it's discovered that the World Bank and the IMF have been making loans which are in direct conflict with the interest of the American farmer, I feel that it's time to take another look at how and why we continue to fund these organizations.

In 1981, the American agricultural exports climbed to a record level of $44 billion. Since that time, the American farmer has been put through an economic wringer of dramatically lower exports, higher interest rates, and an overvalued currency, excess production and falling land values. Farm exports are estimated this year to total no more than $28 billion. To compound the farmer's plight, statistics recently compiled by the Joint Economic Committee revealed that in recent years the World Bank has provided subsidized credit to nations whose farm products have significantly cut into our agricultural export markets.

For example, since 1980, Argentina has increased its share of the world export market of soybean meal from less than 2 percent to roughly 15 percent, while our share of the market has declined by more than half. Yet in 1985, the International Finance Corporation, a subsidiary of the World Bank, loaned Argentina $12 million for the purpose of increasing its soybean production. This story is much the same for wheat. World Bank loans of $111 million have helped Argentina more than double its share of the world wheat market while the U.S. share has declined from a high of 48 percent to its present figure of less than 30 percent.

In Brazil, the commodity is different but the story is much the same. Almost a billion dollars of multilateral financing of livestock production has made Brazil in the last five years the world's fastest growing beef exporter and consequently American beef exports have declined. In China, the issue is pork. The World Bank loans

have helped the Chinese to double their pork exports. Ours have fallen by 50 percent.

Argentina's foreign debt totals almost $53 billion. Brazil's debt is twice that. These nations, as well as other debtor nations, have been forced to service the interest of their debts by running significant trade surpluses. In the case of Argentina, 50 percent of its export income is required to pay the interest on its outstanding foreign loans; 75 percent of Argentina's export income is accounted for by farm exports.

In reality, what has happened is that the World Bank has provided debtor nations like Argentina with the capital to significantly improve their agricultural production so that they can increase their exports, undercut American farm prices, and earn enough hard currency to pay the interest on outstanding loans which are held mostly by American banks. Now forgive me if I find this process just a little obtuse. Furthermore, I am tired of the interest of the American farmer taking the back seat to the interest of the State Department.

Not only are the United States farmers hurt by the debt crisis in Latin America, but American industry suffers as well. Economists at the Wharton School estimate that the debt situation has cost our economy more than 800,000 jobs because these nations are unable to afford U.S. exports. First, the banks made bad loans which the debtor nations are unable to repay, then the World Bank, an organization we help finance, turns around and loans these nations additional money so that they can produce crops for exports which are already in surplus on the world market. We, on the other hand, are left no choice but to have the Commodity Credit Corporation purchase more and more of our surplus crops further depressing the prices and costing the American taxpayers still more money in farm support. The banks are happier, but the American farmer loses.

I am for economic development throughout the underdeveloped world, but I am not for economic policies which create more surplus crops, hurt U.S. farmers, and cost the taxpayer. That is why I am pleased to be a co-sponsor of the Foreign Agricultural Investment Reform Act because frankly even the thought of tax dollars paid by the American farmer going to subsidize his competitors in Argentina, Brazil, or anywhere else for that matter, is obscene. And I am here to help bring a stop to it.

With that, I would like to say that I am looking forward to hearing the testimony, but first I want to call upon one or more active members of this committee, Senator Mack Mattingly.

## OPENING STATEMENT OF SENATOR MATTINGLY

Senator MATTINGLY. Thank you, Mr. Chairman. I am happy to join with you today in welcomig these witnesses in order that we might be able to gather their input regarding the manner in which foreign agriculture is developed and stimulated through the infusion of loans and grants made by the multilateral lending organizations.

As you know, I have long been concerned about the effect that loans made by the World Bank and other organizations have on

our own domestic farm producers and processors. In fact, I sponsored amendments to one of the funding measures two years ago which became public law in which the Senate attempted to impose severe restrictions on those borrowers who were determined to be guilty of using unfair predatory subsidies to compete with U.S. exports or who erected trade barriers against the importation of our products.

It does appear to be a total contraction to say that we are going to promote and improve the export of American agricultural products and, on the other hand, to contribute to organizations which furnish low interest or sometimes no interest loans to promote foreign agricultural production.

Mr. Chairman, I just hope that these hearings will help some of us here in the Congress in our attempts to convince our colleagues that the time has come to reevaluate our continued participation in financing our foreign competition through the multilateral banking developing organizations.

I thank you for holding these hearings and hopefully they will be enlightening for the Congress and maybe some other people also.

Senator ABDNOR. Well, thank you, Senator Mattingly. And they are very timely hearings and thank you for that statement.

With that, I will call our first witness, Congressman Beau Boulter. He will be accompanied by Mr. Bill Nelson, executive vice president of the Texas Wheat Producers Association, and Mr. S.M. True, president of the Texas Farm Bureau. Gentlemen, we are very pleased to have you come here today all the way from Texas.

Congressman, it's a pleasure to have you with us this afternoon accompanied by your two witnesses and you just go right ahead and proceed in any manner you care to.

## STATEMENT OF HON. BEAU BOULTER, A U.S. REPRESENTATIVE IN CONGRESS FROM THE 13TH CONGRESSIONAL DISTRICT OF THE STATE OF TEXAS

Representative BOULTER. Thank you, Mr. Chairman, very much. I am pleased to have the opportunity to visit with you and to appear before the Subcommittee on Agriculture and Transportation of the Joint Economic Committee and to speak in behalf of a policy reform which I think you very eloquently addressed, Senator Abdnor, that's long been overlooked by Congress. I am heartened by the initiative that you have shown and has been shown by my colleague, Senator Steve Symms, in arranging a hearing on this very important issue which has also, I might add, become increasingly important to the agricultural community and the taxpaying public at large.

Foreign Agricultural Investment Reform, FAIR, as we call it, is of critical importance to farmers whose livelihoods depend on commodity prices and a share of export markets, both of which have slipped precipitously in recent years, due in large part to an ill-conceived policy that subsidizes foreign agricultural production that directly competes with our own. I seriously doubt that this improvident policy is supported by the general public. In this era of fiscal restraint, it is high time that the multilateral lending institutions, which have prospered greatly due to the generosity of the U.S. tax-

payer, become accountable to their majority shareholders—the American taxpayers. The time has come for a new, common sense policy, and that is why you, Senator Abdnor, and Senator Symms and I have formed a coalition to push for foreign agricultural investment reform.

We may be on our way to influencing the climate of opinion. Just last week, the House Budget Committee, of which I am a member, passed an amendment I offered to the FY '87 budget resolution expressing the sense of Congress that the subsidization of foreign agricultural commodities already in surplus is a counterproductive use of American tax dollars and has a devastating effect on our farmers who lose export markets to unfairly subsidized competition. Convincing the House Budget Committee that a major problem exists is a good first step in the House. We must now go about the process of convincing both the Congress and the administration that the current policy direction must be changed.

Since Senator Symms and I introduced this legislation last fall to curtail U.S. taxpayer support of subsidized foreign agriculture, we have also undertaken the process of educating members of the House and Senate, the media, constituents and other interested parties of the imminent need to inject fairness into the system.

And, Senator, with your permission, I will make my prepared statement, all of it, a part of the record but I point out several examples of how we have been building a constituency across this country.

As you well know, the American farming community has been severely depressed for several years. In a December 1985 report, the House Agriculture Committee noted that the nation's agricultural economy is in a depression as severe as any the industry has faced since the 1930s. The Department of Agriculture has reported that half of all farmers have a negative cash flow and cannot meet operating or family living expenses from combined farm and off-farm earnings. Since 1981, average farm real estate values have fallen by more than 33 percent. In many states, this decline has exceeded 50 percent. A number of economists predict an additional 20 percent drop in farmland values nationwide during 1987.

One of the chief causes of the depression in agriculture today is the loss of our export markets. U.S. farm exports have declined from a 1981 peak of $44 billion to an estimated $32 billion in 1985, and as you point out, Mr. Chairman, we're expecting like $28 billion currently.

It should be obvious to even the casual observer that we cannot continue to finance our foreign competition. We have severe problems here at home and we must address them now, while we still have a viable agricultural industry to produce food and fiber for ourselves and the rest of the world.

Trade has become a hot issue in Washington as U.S. export markets continue to shrink, throwing thousands of workers out of work. In fact, the House is scheduled to consider a comprehensive trade reform bill this week. In reviewing this measure, I was disappointed to discover that the bill is seriously lacking in several areas of trade reform. The bill is laden with protectionist measures, but these are only short-term remedies. The bill does not speak to one of the major underlying reasons for the flood of cheap foreign

imports into this nation, and that is subsidization by the multilateral lenders.

In the agricultural sector alone, there are numerous dramatic examples that describe the trade war, which we are currently losing. One such example is the U.S. export market for wheat. Since 1980, the U.S. percentage of the world export market for wheat has fallen from 44 percent to 30 percent. Meanwhile, Argentina's share of the world market has doubled. And during this same period of time, Argentina borrowed at relatively low interest rates millions of dollars from the multilaterals for the enhancement of wheat production and other agricultural products. Similar examples can be cited for rice, soybeans and cotton, where U.S. exports have fallen dramatically from 40 percent of the market to 16 percent from 1981 to 1985.

Why has there been such a dramatic increase in foreign agricultural exports in such a short period of time? One reason is that many of the borrowing countries are hard pressed to repay their outstanding foreign debt, which in the case of Latin American countries totals $370 billion. The large international banks, which participated in a virtual orgy of lending in the 1970s hold approximately two-thirds of this debt and are putting the squeeze on their borrowers to generate currency to service the debt. It's no small wonder that the $8.4 billion IMF "replenishment" approved by Congress in 1983 has been described as a "big bank bailout."

Have the multilaterals begun to change their tune? I don't think so. The World Bank just recently announced that it will lend Argentina, a major U.S. agricultural export competitor, $350 million in order to help boost its farm exports $1 billion a year by 1989. And more loans are apparently on the way as the Bank prepares to loan Argentina about $1 billion within the next year or so to "support the country's economic reform."

Today we have only focused on the agriculture industry, but many other industries are similarly affected by multilateral sponsored production subsidies. The U.S. copper industry is a prime example and, Senator Abdnor, I am also introducing a bill in the House to speak to the copper industry as well.

But let me focus for a moment on how the FAIR bill would work. The first part of our proposal would require the Treasury Department to instruct the U.S. executive directors of the multilateral banks to vote against all loans for the production of export agricultural commodities that are already in surplus on world markets. This is something that the U.S. has done in the past on a case-by-case basis. Part two of the bill is the enforcement mechanism. Should the loans referred to in part one be approved despite the United States' opposing vote, then the U.S. share of contributions to the lending multilateral would be reduced by an amount equal to the U.S. share of each loan made.

I think this is a fair policy that will bring pressure to bear on officials at the Treasury and the multilaterals to more carefully scrutinize those loans which may harm U.S. interests. It does not prohibit multilateral lending for agriculture. It merely sets down as a matter of law that it should be the policy of the United States to oppose agriculture loans that harm our own agricultural industry.

I must say that I am disappointed that the Treasury Department did not agree to participate in today's hearing. As the federal governing body with jurisdiction over the U.S. participation in multilateral lending, the Treasury might have been able to enlighten us as to how we might go about remedying the current situation. The Treasury's refusal to participate, I think, is a reflection of their embarrassment over the current state of affairs at the multilaterals.

There comes a time, Mr. Chairman, when even the great resources of the U.S. can no longer keep the world economy afloat. We have reached that point. Our past acts of benevolence have indeed been instrumental in equipping our trade partners and competition with resources to build up their own basic industries and infrastructure. However, at a period in time when U.S. export markets are under siege, it becomes apparent the policy debate must swing back to the question of what is in the best interests of the American people. In answer to that question, you and Senator Symms and I have introduced a proposal which we think is fair to the farmer, fair to the taxpayer, and in fact fair to the developing countries as well. It's fair to the taxpayer and farmer for obvious reasons. But it's also fair to developing countries in that it discouraged ill-advised short term investments that are merely mechanisms for servicing debt. The kind of loans that FAIR opposes are, by definition, unprofitable loans. Rarely do farm products in surplus on world markets yield anything but break-even prices at best. So it is in the best interests of these developing countries to pursue investments that will yield long-term growth, no long-term debt.

In conclusion, Mr. Chairman, I would once again like to thank you and other members for their cooperation and efforts in bringing Foreign Agricultural Investment Reform to the forefront of issues of interest to the subcommittee. I believe the support shown today by the subcommittee, agriculture and taxpayers' groups and other parties confirms my belief that there is an awakening to the fact that a reassessment of current policy is in order. I am excited to be a part of this effort and look forward to working with each of you in the future as we mold a new policy that represents the best interests and desires of the American people. Thank you very much, Mr. Chairman.

[The prepared statement of Representative Boulter follows:]

## Prepared Statement of Hon. Beau Boulter

Mr. Chairman, I am very pleased to have the opportunity to appear today before the Joint Economic Committee and to speak in behalf of a policy reform that I believe has long been overlooked by the Congress. Indeed, I am truly heartened by the initiative shown by my colleague Senator Steve Symms in arranging this hearing on an issue which is becoming increasingly important to the interests of our agriculture community and the tax paying public at large.

Foreign Agricultural Investment Reform, FAIR as we call it, is of critical importance to our farmers whose livelihoods depend on commodity prices and a share of export markets, both of which have slipped precipitously in recent years, due in part to an ill-conceived policy that subsidizes foreign agriculture production that directly competes with our own. I seriously doubt this improvident policy of sending U.S. taxdollars overseas to our competition is supported by the general public either. In this era of fiscal restraint, it is high time that the multilateral lending institutions, which have prospered greatly due to the generosity of the U.S., become accountable to their majority shareholders--the American taxpayers. The time has come for a new, common sense policy, and that is why Senator Symms and I have formed a coalition to push for Foreign Agricultural Investment Reform.

We may be on our way to influencing the climate of opinion. Just last week the House Budget Committee, of which I am member, passed an amendment I offered to the FY87 budget resolution expressing the sense of Congress that the subsidization of foreign agricultural commodities already in surplus is a counterproductive use of American tax dollars and has a devastating effect on our farmers who lose export markets to unfairly subsidized competition. Convincing the House Budget Committee that a major problem exists is a good first step. We must now go about the process of convincing both the Congress and the Administration that the current policy direction must be changed.

Since Senator Symms and I introduced legislation last fall to curtail U.S. taxpayer support of subsidized foreign agriculture, we have undertaken the process of educating Members of the House and Senate, the media, constituents and other interested parties of the imminent need to inject FAIRNESS into the system. During the past six months as I have crisscrossed the thirty-seven counties of my congressional district, speaking to civic groups and attending town hall meetings, I have made a point of mentioning the FAIR initiative. More recently, as I have returned to these same communities I have encountered on more than one occasion groups of constituents who want to know if any congressional action has taken place on the FAIR bill, and what the prospects are for future consideration. The interest extends beyond my district and the state of Texas, too. In fact, I have been contacted by journalists outside of Texas and have

participated in call in radio talk shows to discuss the bill. The point I am trying to make is that we are beginning to broaden our existing coalition and pick up support from individuals and groups who are dismayed and disenchanted with current U.S. international lending policies.

I don't have to tell anyone here today how dire the situation is for many of our farmers. We are all painfully aware of the statistics. As we all know, the American farming community has been severely depressed for several years. In a December 1985 report, the House Agriculture Committee noted that the nation's agriculture economy is in a depression as severe as any the industry has faced since the 1930s. The Department of Agriculture has reported that half of all farmers have a negative cash flow and cannot meet operating or family living expenses from combined farm and off-farm earnings. Since 1981, average farm real estate values have fallen by more than 33%. In many states, this decline has exceeded 50%. A number of economists predict an additional 20% drop in farmland values nationwide during 1987.

One of the chief causes of the depression in agriculture today is the loss of our export markets. U.S. farm exports have declined from a 1981 peak of $44 billion to an estimated $32 billion in 1985, a decrease of $12 billion, or over 27% since 1981.

It should be obvious to even the casual observer that we cannot continue to finance our foreign competition. We have severe problems here at home, and we must address them now, while

we still have a viable ag industry to produce food and fiber for ourselves and the rest of the world.

Trade has become a hot issue in Washington as U.S. export markets continue to shrink, throwing thousands of workers out of work. In fact, the House is scheduled to consider a comprehensive trade reform bill this week. In reviewing this measure, I was truly disappointed to discover that the bill is seriously lacking in several areas of trade reform. The bill is laden with protectionist barriers, but these are only short-term remedies. The bill doesn't speak to one of the major underlying reasons for the flood of cheap foreign imports into this nation: subsidization by the multilateral lenders.

In the ag sector alone, there are numerous dramatic examples that describe the trade war, which we are currently losing. One such example is the U.S. export market for wheat. Since 1980 the U.S. percentage of the world export market for wheat has fallen from 44% to 30%. Meanwhile, Argentina's share of the world market has doubled. And during this same period of time, Argentina borrowed at relatively low interest rates, millions of dollars from the multilaterals for the enhancement of wheat production and other agriculture products. Similar examples can be cited for rice, soybeans and cotton, where U.S. exports have fallen dramatically from 40% of the market to 16%, from 1981 to 1985.

Why has there been such a dramatic increase in foreign agriculture exports in such a short period of time? One reason is that many of the borrowing countries are hard pressed to repay

their outstanding foreign debt, which, in the case of Latin American countries, totals $370 billion. The large international banks, which participated in a virtual orgy of lending in the 1970s, hold approximately two-thirds of this debt and are putting the squeeze on their borrowers to generate currency to service the debt. It's no small wonder that the $8.4 billion IMF "replenishment" approved by Congress in 1983 has been described as a "big bank bail-out".

Have the multilaterals begun to change their tune? Don't bet on it. The World Bank just recently announced it will lend Argentina, a major U.S. ag export competitor, $350 million in order to help boost its farm exports $1 billion a year by 1989. And more loans are apparently on the way, as the Bank prepares to loan Argentina about $1 billion within the next year or so to "support the country's economic reform".

Today we have only focused on the agriculture industry, but other industries are similarly affected by multilateral sponsored production subsidies. Take the U.S. copper industry, for example. This industry, which is vitally important to my district, has virtually collapsed as a result of competition with subsidized copper producers in Chile and Peru. From 1975 to 1983 Chile and Peru received $583 million and $728 million, respectively, in development bank loans for mining and mining-related projects. Even though much of the U.S. industry modernized during this time, its production costs were significantly higher than that of Chile. In 1983 the production cost of a pound of copper in Chile was 45 cents; in the U.S. it was 69 cents. So you see, agriculture is not the only industry

taking it on the chin as a result of multilateral lending activities.

Let me focus for a moment on how the FAIR bill the Senator and I have introduced would work. The first part of our proposal would require the Treasury Department to instruct the U.S. executive directors of the multilateral banks to vote against all loans for the production of export ag commodities that are already in surplus on world markets. This is something that the U.S. has done in the past on a case by case basis. Part two of the bill is the enforcement mechanism. Should the loans referred to in part one be approved despite the U.S.' opposing vote, then the U.S share of contributions to the lending multilateral would be reduced by an amount equal to the U.S. share of each loan made.

I think this is a fair policy that will bring pressure to bear on officials at the Treasury and the multilaterals to more carefully scrutinize those loans which may harm U.S. interests. It does not prohibit multilateral lending for agriculture. It merely sets down as a matter of law that it should be the policy of the United States to oppose agriculture loans that harm our own ag industry.

I must say that I am disappointed that the Treasury Department did not agree to participate in today's hearing. As the federal governing body with jurisdiction over the U.S' participation in multilateral lending, the Treasury might have been able to enlighten us as to how we might go about remedying the current situation. The Treasury's refusal to participate, I think, is a reflection of their embarrasment over the current

state of affairs at the multilaterals.

There comes a time when even the great resources of the U.S. can no longer keep the world economy afloat. We have reached that point. Our past acts of benevolence have indeed been instrumental in equipping our trade partners and competition with resources to build up their own basic industries and infrastructure. However, at a period in time when U.S. export markets are under siege, it becomes apparent the policy debate must swing back to the question of what is in the best interests of the American people. In answer to that question, the Senator and I have introduced a proposal which we think is fair to the the farmer, the taxpayer and developing countries. It's fair to the taxpayer and farmer for obvious reasons. But it's also fair to developing countries in that it discourages ill-advised short term investments that are merely mechanisms for servicing debt. The kind of loans that FAIR opposes are, by definition, unprofitable. Rarely do farm products in surplus on world markets yield anything but break-even prices. So it is in the best interests of these developing countries to pursue investments that will yield long-term growth, not long-term debt.

In conclusion, Mr. Chairman, I would once again like to thank the Senator and other members for their cooperation and efforts in bringing Foreign Agricultural Investment Reform to the forefront of issues of interest to the subcommittee. I believe the support shown today by the subcommittee, agriculture and taxpayer's groups and other parties confirms my belief that there is an awakening to the fact that a reassessment of current policy is in order. I am excited to be a part of this effort and

look forward to working with each of you in the future as we mold a new policy that represents the best interests and desires of the American people. Thank you.

Senator ABDNOR. Thank you, Congressman Boulter. Let me tell you, it's a real pleasure for us to work with you on this major problem and certainly you're taking the leadership in it, you and Senator Symms, and we commend you and you stated the case and the problem extremely well and we thank you for that statement.

Do you want to introduce your two colleagues or shall we just go ahead and call on them?

Representative BOULTER. I might add, Mr. Chairman, that Mr. Nelson is from my 13th Congressional District of Texas and S.M. True lives right outside of my district and is here on behalf of the Texas Farm Bureau.

Senator ABDNOR. First, let me say your entire statement will be placed in the record in case you leave some of it out, and whichever one of you two gentlemen wants to go first may proceed.

## STATEMENT OF S.M. TRUE, JR., PRESIDENT, TEXAS FARM BUREAU

Mr. TRUE. Mr. Chairman and members of the subcommittee, I am S.M. True and I serve as president of the Texas Farm Bureau. I am a cotton and a grain producer from Plainview, Texas, in the high plains area of the state. The Texas Farm Bureau is the largest agricultural organization in the State of Texas and represents producers of all commodities produced in our huge state, many of them which are heavily dependent upon export markets.

I appreciate the opportunity to express the Farm Bureau's view on this issue of great importance to American farmers, the foreign agricultural investment priorities. The Farm Bureau supports efforts by Congress to review the charter for the World Bank to determine if it is operating according to its original purpose of aiding economic development and reconstruction and in keeping with world banking practices. Further, we support a thorough congressional evaluation of the U.S. contribution to the capital stock of the World Bank with emphasis on taxpayer costs and effects on world poverty.

The Farm Bureau opposes practices by the World Bank of lending to developing countries at fixed interest rates. These countries must not be insulated from the effect of inflation on interest rates and the higher cost to U.S. taxpayers in servicing long-term loans at favorable interest rates. In other words, we believe recipient countries should not be given undue preferential treatment that provide unfair advantage over U.S. agricultural producers. We also oppose the World Bank loans to countries that subsidize products that are in direct competition with the United States.

American farmers are generally displeased with the conduct of the World Bank, particularly since it carries out the lending operations at the U.S. taxpayers' expense. American agriculture is experiencing significant economic pressures caused by low commodity prices, relatively high interest costs, loss of markets, and declining asset values. We believe it is very unwise public policy to add to those pressures through unfair lending practices to foreign competitors funded with money from our own country.

The recent report in the press of the World Bank's loan to Argentina is an example of the activities which make us, as farmers,

unhappy. That case involved a loan for the specific purpose of allowing Argentina farm exports to become more competitive in world markets and, Mr. Chairman, I'd like to submit to the subcommittee for the record the text of a letter sent by American Farm Bureau President Dean Kleckner to Treasury Secretary Baker on that issue. I have that and I will submit it for the record.

Senator ABDNOR. We will make it a part of the record, without objection.

[The letter referred to follows:]

April 9, 1986

The Honorable James A. Baker, III
Secretary of the Treasury
U.S. Department of the Treasury
Room 3330 Main Building
15th Street and Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Baker:

We have read with great concern recent press accounts of a U.S.-backed initiative by the World Bank to aid Argentine farmers. This aid would be through loans aimed at boosting exports. We understand that similar financial packages are also being developed for Brazil and Mexico.

You are, of course, well aware of the current debt crisis in the U.S. farm sector. We have discussed this with you and other Administration officials on a number of occasions. Farm Bureau members find it difficult to accept that (1) loans are available to benefit foreign farmers when American farmers are being foreclosed, and (2) foreign loans are being targeted for the purpose of increasing exports in direct competition with U.S. commodities.

American farmers are not afraid of fair foreign competition. We have long contended, however, that we are forced to compete as much with foreign treasuries as with foreign farmers in world markets. Now it seems we will be competing against our own treasury as well.

Let me assure you that Farm Bureau understands fully the need to promote economic development in the third world. It is in these countries that the growth potential lies for future increases in our agricultural exports. However, the recently announced and proposed loans by the World Bank are directed at two of our biggest competitors. Argentina and Brazil, and to a certain extent Mexico, have never been traditional and reliable markets for U.S. agricultural goods because of longstanding protectionist import policies. Loans or aid of any sort to encourage exports from those countries should be dependent on and tied to meaningful improvements in access to those markets for agricultural products. Without such commitments we see the World Bank actions as simply putting additional downward pressure on U.S. exports.

Farm Bureau urges that these loan arrangements be reconsidered in light of the economic and political repercussions that will be felt throughout the domestic farm community if foreign farmers are given preference over U.S. farmers.

Sincerely,

Dean Kleckner

Mr. TRUE. In it you will see that a major concern of ours is the targeting of loans for the purpose of increasing foreign production and export of commodities that are directly competitive with those produced and exported by the United States.

We believe that other international lending institutions have made some of the same mistakes. However, I do not want to appear to be implying that all international agricultural projects are unworthy. We encourage congressional review of the general activities of international financial organizations to determine whether they are in fact carrying out their mission. Within such a study the effectiveness of international loan activities should be considered. We would like to know whether projects are sufficiently screened for their cost effectiveness and for their long-term impact on the economies of both the recipient country and other affected countries.

Mr. Chairman, the Farm Bureau recognizes the need to promote economic development in less developed nations. If we ever hope to return to the days of $40 billion annual farm exports we will need greatly increased demand and purchasing power in those same countries. Our trade grew during the decade of the 1970s largely on the strength of increasing world demand and that is how we will likely achieve such growth again.

We believe that development assistance programs can be of major importance in improving the economies of undeveloped nations. However, such programs should be based upon well formulated, long-range plans of the recipient nations in order to ensure proper utilization of aid funds and technological assistance. We do not believe that the current operations of international development banks have been based upon well formulated, long-range plans.

The Farm Bureau believes that long-range plans at improving the economies of the beneficiary countries should take into account their trade policies. It appears to us that their industries and economies are fequently isolated from international trading rules and are largely dependent upon protectionist trade barriers. One criteria for future loan agreements should be some form of trade liberalization by recipient countries.

The Foreign Agricultural Investment Reform bill introduced by Texas Congressman Beau Boulter and others appears to us to be an excellent starting place for consideration of needed changes in U.S. participation of international lending institutions. The Texas Farm Bureau delegates at last January's American Farm Bureau convention in Atlanta proposed a resolution based upon the concept of the FAIR bill which passed and is now American Farm Bureau policy and that resolution states:

> Efforts should be made by the Administration and the Congress to reduce U.S. Government contributions to international lending institutions which stimulate investment in the production of crops and livestock which ultimately competes with U.S. agricultural producers.

American agriculture has yet to benefit from the recovery of the general U.S. economy. We are anxiously awaiting our turn. Farmers and ranch members continue to decline. Commodity prices remain depressed. Interest cost have tapered off only slightly. Land

values and other ag assets are declining. Exports are plummeting and the U.S. share of world markets is likewise decreasing.

In place now are many new policies, including the new farm bill, export enhancement programs, credit regulations and monetary reform, which is aiding interest rates and the value of the dollar. It seems that the concept and the philosophy of the farm bill should also be implemented by the United States Government in order to ensure that all possible corrective actions are taken in the area of public policy.

In conclusion, the Farm Bureau supports efforts to reevaluate the role the United States plays in supporting international development organizations. We believe such a review of the benefits and costs of the multilateral lending institutions is long overdue and desirable at this time. I thank the members of this subcommittee for your time and efforts in this regard. Thank you, Mr. Chairman.

Senator ABDNOR. Well, thank you, Mr. True. We appreciate you coming all the way from Texas to testify.

I know you speak for the Texas Farm Bureau and sometimes they differ. Do you think that the national would be inclined to put their endorsement on this?

Mr. TRUE. Yes, sir. I have worked through the American Farm Bureau and I think my statement certainly reflects the American Farm Bureau's thinking.

Senator ABDNOR. Thank you. Mr. Nelson, please proceed.

## STATEMENT OF BILL NELSON, EXECUTIVE VICE PRESIDENT, TEXAS WHEAT PRODUCERS ASSOCIATION

Mr. NELSON. Thank you, Mr. Chairman. My name is Bill Nelson and I'm representing the Texas Wheat Producers Association.

In the 1984–85 marketing year, Texas was the third largest wheat producing state having produced 187 million bushels. While the overall U.S. wheat producing industry exports between 50 and 60 percent of production, in Texas we generally export 90 percent of what we produce in wheat. Besides being a major wheat producing state, Texas is also the home of the six grain export ports, including the nation's largest wheat export port located in Houston. The entire wheat export industry in Texas, which includes farmers, rail and trucking employees, inspection personnel, grain elevator employees, longshoremen, and others, employs on a full-time basis over 20,000 people.

The current situation facing Texas and other U.S. wheat producers in the world wheat market is one of intense competition. Wheat export volume is expected to fall nearly 40 percent from last year's level. The value of wheat exports will likely fall by even more due to the farm program related drop in wheat prices. This will have an extreme effect not only on farm income but also on the cost to the government for storing surplus grain and on our overall trade deficit.

A striking example of the effect on our trade deficit can be found in calendar year 1985 trade statistics. As you all know by now, the U.S. trade deficit in that year rose $25 billion over the 1984 deficit to $148 billion. Of that $25 billion, the drop in the value of wheat exports alone accounted for 11 percent of the increase.

As you can see from these numbers the U.S. wheat export industry has its work cut out for it if we are to compete in the world market and regain our share. Producers are doing their part in wheat and market development programs around the world. That is why I am here today to address a subject that can have a drastic impact on the future level of wheat exports and farm income.

The continued participation of the U.S. in multilateral lending which increases foreign agricultural production and exports of crops that are already in surplus here and around the world will only make our situation worse.

Let me state that the producers I represent do not oppose all U.S. participation in multilateral lending to developing countries. What we do oppose is U.S. participation in loans that do not take into account to the degree necessary the world market situation and, more importantly, the interest of affected U.S. industries.

I would like to refer to a recent World Bank loan to Argentina of $350 million to be used to boost their exports of agricultural products, including wheat, according to their own press release. The World Bank estimates that the loan will help Argentina generate an additional $1 billion in export earnings by 1989.

Unfortunately, much of the increase in Argentine exports will come not only at the expense of U.S. taxpayers but, more importantly, at the expense of the many farmers and other workers who produce and export American wheat at lower prices due to the U.S. backed competition.

More specifically, I want to point out our two principal concerns regarding this and any other similar loans.

First, the reforms this loan will make possible in Argentina will serve to undermine the effectiveness of the Farm Security Act of 1985. The farm bill which passed last year was designed to place greater emphasis on market forces in deterring farm income. For wheat and several other commodities the focal points of the bill were the lowering of price support loan rates and the strengthening of USDA export credit and food aid programs. The thought was that these actions combined would help us regain our lost market share in world markets by making us more competitive. While not all U.S. producers agreed on the specifics of the bill, I think it is safe to say that they would agree that World Bank actions such as the one I've discussed today would undermine the intent of our domestic farm programs. This would result in a continued loss of market share which would reduce farm income and increase government spending. We see this as a classic example of the right hand not knowing what the left hand is doing.

Our second conern centers on the terms of the Argentine loan. The loan is for 15 years, including three years of grace, with a variable interest rate, currently 8.5 percent, linked to the cost of the banks borrowings. It also carries an annual commitment charge of 0.75 percent on undisbursed balances.

When our farmers compare these terms to what they are able to get for their own operations they have every right to be upset. Our farmers are currently having to pay from 12 to 17 percent for operating loans. Before receiving such loans, farmers must demonstrate the ability to cash flow that particular enterprise. This ability to cash flow is made much more difficult when their competition is, in

effect, being subsidized by the much more favorable World Bank terms. We recognize the concern in the U.S. and international banking community over Argentina's ability to service its huge foreign debt and we realize that this concern was probably the primary stimulus for making this loan. I will, however, remind the banking industry that while making loans such as this may help their position in Argentina, it will likely weaken an already tenuous farm debt situation in the United States.

In closing, I want to once again stress the seriousness of the situation facing the Texas and U.S. wheat export industries. Falling levels of exports, employment and farm income are all symptoms of our export crisis. We are, however, confident that the industry can make a comeback if U.S. Government policies are carefully formulated. We are happy to see that our concern is shared by Senator Abdnor and my own district Congressman Beau Boulter and others in Congress.

One option being considered, we understand, would be to require the U.S. executive directors of international financial institutions to vote against all loans to produce or enhance the export of commodities already in surplus. If such loans are approved in spite of the U.S. opposition, then our contribution to an international financial institution is reduced by an amount equal to the U.S. share of each objectionable loan. We are here to emphasize the need for and to support such a change in U.S. policy.

I thank you, Mr. Chairman, for the opportuntiy to be before you today.

Senator ABDNOR. Thank you, Mr. Nelson. I happen to be—or was, I guess—I'm not quite as active as I was—a wheat producer and I was a farmer before I arrived in Washington and I like to think I still am one. I know the problems and I'm still involved and I have been a member of the Wheat Growers and at one time I was a member of the Farm Bureau, but that doesn't solve our problem.

It's very depressing to see people have to fight the government instead of working with the government on some of this and I certainly congratulate you, Congressman, for getting a sense of Congress resolution included in that budget. It's a start and when it gets to the floor we will remind them of it. Maybe we should have had Steve put that in the one in the Senate, but I guess it got by us but it's still coming up some day to be discussed on the floor because that's a good endorsement and it's a good start and it's something that's very badly needed.

I don't know how far this is going to have to go, but do you feel when you brought that up in the Budget Committee that most of the members really realized what they were voting on there? That was a good place to try it out.

Representative BOULTER. Actually, there was a lot of discussion and we discussed it for maybe 15 minutes or so and I think they did. They were concerned about the ability of the developing countries to be able to renegotiate and make interest payments to big banks and that was brought up, but there is, Senator, a lot of concern on my side of the Capitol about also our rural banks and our rural communities and I personally just wish that we applied the same standards to the bigger banks in our country who have made these third world loans that we apply to these little community

banks and rural banks throughout our country. Their debt load is just as bad and our version of the third world loan is in many cases these ag loans.

Senator ABDNOR. I just heard Secretary of Commerce Baldrige today and we talked to him about trade and it was very interesting. And from what I see, I commend the Secretary. I think he's one of the few outspoken people over there who's trying to do something and gather some different programs not only for the underdeveloped world but what we see taking place in the more developed countries isn't very encouraging to farmers either.

Somehow you and I and enough others are going to have to get through to the State Department that farmers should have some input in the Agriculture Department and that this is a two-way street. If they want people paying taxes to loan their money out, they'd better help make farmers a little more prosperous again.

Well, gentlemen, we thank you very much for coming all the way here, for your support. I think it will take a fight but we'll get it done if we keep working together.

Representative BOULTER. We will work with you, Mr. Chairman.

Senator ABDNOR. Congressman Kramer was due but he hasn't been able to arrive yet, so we will go ahead with Mr. George Pope, Assistant General Sales Manager and Assistant Administrator, Export Credits, Foreign Agricultural Service, U.S. Department of Agriculture. We appreciate your being here today. I hope we haven't spoken too harshly, but we will be interested in your testimony.

**STATEMENT OF GEORGE J. POPE, ASSISTANT GENERAL SALES MANAGER AND ASSISTANT ADMINISTRATOR, EXPORT CREDITS, FOREIGN AGRICULTURAL SERVICE, DEPARTMENT OF AGRICULTURE**

Mr. POPE. Thank you very much, Mr. Chairman. I think we'll find that we're in great sympathy with the previous speakers.

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to discuss with you the foreign agricultural development projects.

As you know, the Department of Agriculture has a long history of working with other nations on a variety of projects designed both to provide for their immediate food needs and to help them develop their own agricultural infrastructure.

In addition to our long-standing donation and concessional credit sales programs, two provisions of the new farm bill focus on the use of the private sector to promote economic growth in developing countries. The objective of these programs is self-reliance for the countries involved.

The Food for Progress program seeks to help improve agricultural productivity among poor farmers, primarily in African countries where per capita food production has been declining. This program will allow for multiyear planning to achieve policy changes to allow market forces to operate and stimulate food production. The U.S. Government, through food aid, will support these policy changes.

The second new program, a local currency loan initiative, is directly targeted to the private sector in participating countries. Under this program, the U.S. Government will receive local currency in payment for food aid commodities. We will then loan that currency to private financial institutions in the recipient country to provide loans to the private sector.

The legislation places the emphasis of these programs on the local agricultural sector. These new private sector initiatives will complement other development efforts already being supported by U.S. food aid.

Another development effort the Department has supported actively is the Caribbean Basin Initiative. The CBI promotes private sector investment to accelerate agricultural development in the region.

The Department has worked to solicit the support and participation of the U.S. private agricultural sector in the CBI effort and to help beneficiary countries participate in international trade.

With respect to the CBI's impact on U.S. agricultural interests, USDA is monitoring all imports of perishable products to prevent injury to domestic producers. The CBI has a fast-track provision for emergency relief for U.S. producers injured by imports from the CBI. To date, no U.S. producers have filed a request for this import relief.

We applaud development efforts in the less developed countries and recognize the long-term benefits to U.S. agriculture and to the global economy. If successful, these efforts will lead to increased per capita income in the LDCs and to expanded demand for food and farm commodities. For the poor countries, the percentage of income spent on food is relatively high, so as per capita incomes grow, increased demand for more and higher quality food also occurs, leading to expanding market demand. In the long term, this increased demand will benefit U.S. agricultural producers as these nations turn to the world market for foodstuffs, even though the short-term impact on trade may be negative.

The long-term economic health of the world's major industrial nations depends on the third world's ability to compete because these nations are the markets of the future. Economic considerations as well as humanitarian reasons underscore the importance of helping them grow in to full-scale trading partners. By doing so, we help ourselves as well, for as their economies improve, they will become better markets.

In this context, the Department supports the broad developmental objectives of the World Bank and its lending programs. We support projects to combat hunger and malnutrition and to encourage economic development in the developing countries. However, the Department has taken issue with the few projects geared specifically at production of commodities which are already in surplus on world markets when this assistance will cause injury to U.S. producers of the same, similar, or competing commodities. In this regard, we should note that such projects represent under 5 percent of Multilateral Development Bank lending.

We and the MDBs are also concerned about extending this type of assistance to countries which have been involved in unfair trading practices regarding the commodities in question.

The Department and U.S. agricultural producers were concerned about several projects supported by the World Bank over the past year.

These included proposals to help produce palm oil in Malaysia, Indonesia and Papua New Guinea. Since 1970 Indonesia has borrowed $967 million from the World Bank and the Asian Development Bank to support production of edible oils. In 1984 alone Indonesia borrowed $120 million for these projects.

Other proposed financing of concern was to Argentina and Brazil. U.S. processors have filed a Section 301 complaint with the General Agreement of Tariffs and Trade against Brazil, a major exporter of soybean products, for unfair trade practices.

USDA opposed a loan for $155 million to Brazil for an agricultural extension project. The loan was to support the production of 903,000 tons of soybeans and 47,000 tons of cotton. The production supported by this project represents a 6 to 7 percent increase in total Brazilian soybean production. It is estimated that the incremental soy oil produced will likely reduce prices by 5 to 6 percent. In addition, the National Soybean Processors' Association has an unresolved Section 301 GATT complaint filed against Brazilian subsidization and import restrictions.

We recognize that the developing countries depend extensively on their ability to export to earn foreign exchange. We also recognize that the United States has a definite stake in helping these nations deal with their economic development and debt problems.

But we must also be firm in calling on all nations to reduce the levels of protectionism in the world market in order to create a climate for global growth and opportunities for efficient producers.

We must also question the long-term benefit to using these funds to encourage production of commodities already in surplus in the world market. Countries should be supported in their broad-based development efforts but their production should be geared in the direction of their own comparative advantage.

Developed nations must join to promote stronger and more balanced growth in developing economies and the consequent strengthening of foreign currencies.

The Department of Agriculture has urged the international financial institutions to encourage debt-burdened third world nations to reduce government impediments to the functioning of markets, encourage private sector production, and substitute equity capital for debt by encouraging both domestic and foreign investment. For the world trade system to flourish, every nation—third world and industrial alike—must continue to dismantle trade barriers and eliminate subsidies and other forms of unfair trade practices.

That concludes my statement, Mr. Chairman.

Senator ABDNOR. Thank you, Mr. Pope, for a very fine statement.

What becomes of these 301's? Do they just get ignored over there? I guess they pile up. The one that was filed on the Brazilian soybeans and you had several listed here—are they just lying there?

Mr. POPE. Mr. Chairman, admittedly, it's a long, drawnout process. I don't quite think "piling up" would be an apt description, al-

though I'm sure as far as our soybean processors are concerned it seems that way.

I know that our trade negotiators and our USDA staff try to keep on top of these virtually on a day-by-day basis, pushing ahead for the exchange of information and pushing these things to a conclusion, but it is quite a complex process that we must go through on this.

Senator ABDNOR. Can you think of any thing in the past year where agriculture has ever won a battle over there on one of those issues? Occasionally I know we do on other products I read about.

Mr. POPE. Mr. Chairman, I think that there have been some successes in the last year. We're pushing ahead with the Europeans and, of course, with the Japanese.

Senator ABDNOR. Okay. But I'm talking about our sympathetic views toward these underdeveloped countries even when it comes at a time that it's risky. I know we are trying with GATT now. I know what's going on, but I also know that sometimes it's more difficult for staff to handle than ever. Their agricultural negotiator—I've heard his name mentioned several times—must have just been in this country because I heard the discussion of several Senators. They didn't get very far with him. This can go on so long, but we have enough problems the way it is with our good friends on our currencies. That's improving somewhat.

But we're on two fronts here—the underdeveloped and the developed nations, but I'm just wondering how far we're going to go in sympathy. I mean, we'd better start developing sympathy to our own industry for agriculture here in this country or we're not going to be around very long.

But I was just curious. In that field of the underdeveloped nations if any of our cases have ever really been won on our side. I don't know of any. Maybe I haven't followed it close enough. I'm just asking you if you can think of any of these underdeveloped countries we've put any kind of restriction on since we started this.

Mr. POPE. Mr. Chairman, I'm not familiar with that. We can find out and prepare a report for you.

Senator ABDNOR. I would appreciate it for the record.

Mr. POPE. Sure.

[The following information was subsequently supplied for the record:]

Status of 301 Cases

Japanese Leather

Since 1963 Japan has maintained quota restrictions on imports of leather and leather footwear. The U.S. has been negotiating for the past eight years for greater access to the Japanese market for these products. In May, 1984 the GATT Council found Japan's leather quota to be inconsistent with its GATT obligations, however meaningful corrective actions were not undertaken by the GOJ. On September 7, 1985 President Reagan announced that he would invoke measures under Section 301 in retaliation for leather and leather footwear quotas unless U.S. complaints were satisfied. A December 1, 1985 deadline for resolution was stipulated.

In late December, before retaliatory measures were invoked, the U.S. and Japan settled the long pending dispute over leather. The settlement package includes:

- replacement of the leather and leather footwear quota system with a tariff-rate quota system;
- opening of the lower tariff scale to importers on a first-come first-served basis with new importers being eligible for quota shares on an equal basis with established exporters;
- increased duties on Japanese leather imports to the U.S.;
- monetary compensation through reductions or elimination of tariffs on 137 items;
- guarantees by Japan to make permanent earlier tariff reductions on 242 other items; and
- reduction of Japanese tariffs on five aluminum products and a commitment to further consultations on aluminum trade.

The new leather tariff-rate quota system was implemented on April 1, 1986, the beginning of the Japanese fiscal year. The concessions on leather and leather footwear are estimated to be worth $14 million in increased U.S. leather and leather footwear trade.

## INACTIVE OR COMPLETED 301 CASES IN AGRICULTURE

### EC Canned Fruit and Raisins

The U.S. processed fruit industry 301 petition alleged that EC production subsidies for canned peaches, canned pears and raisins impaired EC tariff concessions to the U.S. and inhibited U.S. exports of these products to the EC. After unsuccessful bilateral consultations under the GATT, the U.S. requested a panel. The panel report, favorable to the U.S. on canned fruit and to the EC on raisins, was circulated to all GATT Contracting Parties and was discussed by the GATT Council. The U.S. and the EC were unable to reach a compromise solution to the dispute, and in a September 7, 1985 radio message on trade policy, the President set December 1, 1985, as a deadline for resolution of this matter directing that a list of countermeasures be prepared for implementation if the issue was not settled by then.

Prior to this deadline, the dispute was resolved by the EC agreeing to a 25 percent reduction in its processing subsidy for canned peaches during the 1986/87 marketing year and the eventual elimination in subsequent years of that portion of the subsidy which more than offsets the higher fruit costs faced by EC fruit canners due to the EC's minimum grower price system.

### Poultry (EC and Brazil)

The poultry 301 case, charging the EC with using export subsidies to undercut prices and to gain a more than equitable share of world trade, has been complicated by the EC argument that Brazilian subsidized poultry exports are a major factor in U.S. market displacement. Because of this, proceeding to conciliation with the EC was postponed while Brazil's position in the market was investigated. The U.S. met with Brazil in a series of consultations in 1982 and 1983, but resolution could not be reached. The USG, therefore, decided to go to conciliation before the Subsidies Code Committee.

The GATT Subsidies Code Committee met in Geneva in November 1983 for an initial review of the U.S. complaint. Brazil objected to another round of informal trilateral consultations under the Committee Chairman's auspices, but later agreed to meet in such a forum. Three trilateral meetings were held in Spring 1984 in Geneva. Little progress was made during these meetings. A fourth meeting was more productive. Discussion centered on the EC's over-compensation of its poultry producers for the feed grain cost differential. At the latest meeting on December 3, 1984 the EC expressed an interest in a U.S. proposal that would limit EC export subsidies to their feed cost differential (as an alternative to eliminating subsidies), but they could make no commitment on whether they were able to agree in principle. The U.S. asked the EC again in the summer of 1985 to respond to proposals to resolve the poultry subsidy issue but the answer was non-committal. At present, no date has been set for a future meeting. Meanwhile, indications are that Brazil is no longer subsidizing its exports, although that country will not certify to that effect. Future action may thus be limited to the EC.

## 301 UPDATE - ACTIVE CASES

| COUNTRY AND COMMODITY | WHAT NEXT | KIND | COMMENT |
|---|---|---|---|
| EC<br>Pasta (export subsidy); Citrus (tariff preferences) | Action pending results of informal consultations | Petition | Amb. Yeutter indicated that this issue will have to be resolved shortly or we will be forced to consider another course of action. Negotiations are continuing through informal channels. |
| Brazil<br>Informatics (Trade and investment licensing) | USTR will submit recommendations to the President on or before Sept. 15, 1985 | Self-initiated | U.S. and Brazil have met several times to discuss this issue with little progress. |
| Argentina<br>Oilseeds and Oilseed Products (export tax differentials) | 1st round consultations proposed for mid-June | Petition | In mid-May USTR requested consultations. Arg. has not responded. |
| Japan<br>Manufactured Tobacco (Distribution restrictions, high tariffs, and restrictions against manufacturing) | Consultations are planned for mid-July | Self-initiated | The last round of consultation were held on May 28. No major breakthroughs. |

| COUNTRY AND COMMODITY | WHAT NEXT | KIND | COMMENT |
|---|---|---|---|
| **Japan** | | | |
| Semiconductors (Distribution restrictions in Japan and predatory pricing in the U.S.) | USTR to submit recommendations to the President on or before July 10, 1986 | Petition | USTR & MITI agreed in principle to a broad outline of a settlement. Resolution hoped for by end of June. Commerce has found dumping in all 3 cases under review. In the 64 K DRAM case (petition) ITC has found injury & CVD duties up to 35% are being collected. ITC injury determinations for the other 2 cases, (EPROMS (petition) & 256 K DRAM (self-initiated)), are due Aug. 1. |
| **Korea** | | | |
| Insurance (restrictive market practices) | USTR to submit recommendations to the President on or before Sept. 15, 1986 | Self-initiated | Active negotiations; settlement expected soon. |
| Intellectual Property Rights | USTR to submit recommendations to the President on or before Nov. 3, 1986 | Self-initiated | Active negotiations; settlement expected soon. |

Senator ABDNOR. Have MDB loans to Indonesia and Malaysia affected world production of palm oil? You mentioned something about that in your testimony.

Mr. POPE. Mr. Chairman, I think it's difficult to quantify exactly the relationship between the level of loans and the level of production, but the fact is that since 1970 the world production of palm oil has quadrupled. In 1970, it was some two million tons a year and it's now around eight million tons a year, and in this 15 or 16 year period nearly $1 billion has been loaned to Indonesia alone. So I think there is a definite relationship between the level of loans into these countries and the level of production.

Senator ABDNOR. A billion dollars. What exactly does the 5 percent of the MDB lending represent?

Mr. POPE. Mr. Chairman, this is a figure that our friends at the Treasury Department gave us. It's a Treasury estimate and I think it's probably—well, I don't even want to speculate. I'm not exactly sure what that means.

Senator ABDNOR. Well, what was the position of USDA on the most recent loan of $350 million to Argentina? Do you have any thoughts on that?

Mr. POPE. Yes, Mr. Chairman. In the interagency forum which discussed this loan, USDA opposed this loan for much the same reasons that your previous witnesses discussed. We felt that it was not fair to American producers and that it did clearly cause substantial injury to our American agricultural interests.

[The following information was subsequently supplied for the record:]

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

27 FEB 1986

Honorable David C. Mulford
Assistant Secretary
International Affairs
U.S. Department of Treasury
Washington, D. C. 20220

Dear Mr. Mulford:

Argentina is a major competitor for U.S. agricultural exports in many third country markets. The World Bank has proposed a $350 million agricultural sector loan to Argentina with the stated purpose of stimulating Argentine agricultural production and exports. The loan would offset, in part, revenues lost as a result of lower export taxes.

Argentina's differential export tax system has come under considerable attack by U.S. oilseed processing interests. The National Soybean Processors Association (NSPA) recently filed a Section 301 petition against Argentina's differential export tax system on soybeans and products. This system distorts world trade in oilseeds and products by favoring internal processing of oilseeds over raw material exports, resulting in increasing exports of processed products, i.e., soybean meal and oil and sunflowerseed meal and oil. The differential export tax structure has rapidly expanded Argentina's oilseed processing capacity, adding to world excess capacity. This situation represents a clear misallocation of scarce resources by a major debtor nation.

These policies are a major factor behind stagnating U.S. soybean meal and oil exports and the declining U.S. share of world soybean meal and oil imports. U.S. sunflower oil exports have also been depressed.

Following discussions with USTR and your Department, the industry temporarily withdrew its petition to permit further discussions with the Government of Argentina on export taxes as part of the loan negotiations. We are concerned that the focus of these negotiations is centered on lowering Argentina's export taxes rather than reducing export tax differentials. While the U.S. soybean processing industry has been the most vocal on this issue, the extent

of the problem is pervasive. Export tax differentials exist for virtually every agricultural processing industry in Argentina, disadvantaging other sectors of U.S. agriculture as well.

We urge you to review this loan proposal in light of its potential impact on the U.S. farm community.

Sincerely,

DANIEL G. A[illegible]
Under [illegible]
Affairs and [illegible]

Senator ABDNOR. Well, that's good news and thank you very much.

We appreciate your being here today. If we have any afterthoughts here we'll submit our questions in writing, but we thank you for coming.

Mr. POPE. Thank you, Mr. Chairman.

Senator ABDNOR. Our next witness is a friend of mine, Congressman Ken Kramer, of Colorado. I know of Congressman Kramer's great interest in this and it's a long way over from the House and you're probably busy over there too, but we're happy to have you with us today.

## STATEMENT OF HON. KEN KRAMER, A U.S. REPRESENTATIVE IN CONGRESS FROM THE FIFTH CONGRESSIONAL DISTRICT OF THE STATE OF COLORADO

Representative KRAMER. Mr. Chairman, I'm really delighted to have an opportunity to briefly appear before your subcommittee and I congratulate you for undertaking this matter and also for your interest and hospitality to me.

I would like to open by pledging again my support for the provisions for the FAIR bill, the Foreign Agriculture Investment Reform Act, and I am very thankful that Senator Symms asked me to help spearhead this effort and to participate. It's something that I think is very worthwhile indeed.

As you know certainly, given your home state, far better than I, American agriculture is the envy of the world. We outproduce every country on this planet, with a variety unmatched anywhere. But, unfortunately, Colorado farmers, like those in South Dakota and other places around the country, are really taking it on the chin from countries that don't necessarily play by the same rules. I believe this bill would go a long way toward helping us correct the imbalances that exist and to restore equity in the agricultural exports and trade policies.

The problems facing many of our nation's farmers include low income, high interest rates and falling exports. All of this has made it difficult, and in some cases impossible, for many farmers to simply meet operating costs or in some cases, unfortunately, to avoid foreclosure.

One of the big reasons for low prices is the agriculture surplus that exists today in some of these crops, and a big reason for that surplus is the rapidly diminishing export market. Many Colorado farmers have told me of their frustration over trying to compete with foreign producers who receive generous subsidies from their own governments and who never have to worry about surplus crops or low prices, since their government takes care of them.

To make matters even worse, our government plays a contributing role in this by in fact fostering and helping to maintain some of those unfair export policies coming out of other countries. We as a nation contribute significantly to international lending institutions. The International Monetary Fund is probably the one that's known about the most. That in turn makes loans at very low rates of interest to a number of countries that subsidize their farmers and have unfair export policies.

It makes absolutely no sense—I think it pays to repeat that—it just simply makes no sense for our own taxpayers to support these lending institutions when they turn right around and provide loans that subsidize foreign agricultural producers. It makes no sense for our taxpayers. It makes no sense for our farmers to support unfair agricultural export policies by other countries especially at a time when our farmers and our economy are being hurt through falling exports of our own products.

Our contributions to these organizations are considerable. This year, for example, the United States will contribute more than $1 billion to international lending institutions. Since its inception, the United States has contributed over $20 billion to just one of those institutions, the International Monetary Fund. Ironically, because of huge federal deficits, we borrow in order to make these contributions.

Meanwhile, as more American farmers are shut out of oversea markets and as a steady stream of subsidized agricultural commodities continues to flow into the United States, our agricultural surplus grow and grow and grow. And the result is further declines in prices and in farm income. It's a vicious cycle and one that I believe that your subcommittee, Mr. Chairman, can certainly help put an end to now.

I would like to cite a couple of examples of what I'm talking about of these unfair loans and how they impact on our own farm economy. In 1983, Brazil received a $400 million loan at 11 percent interest from the International Bank for Reconstruction and Development. Since then, Brazil's exports of agricultural products to the United States have increased 67 percent. Meanwhile, this international bank receives 21 percent of its contributions from the United States.

Brazil's competing nation in South America, Argentina, in 1984 received a $60 million loan from the Inter-American Development Bank with the express purpose of stimulating grain and livestock production. Our market share of the world wheat market in that period of time diminished from 44 to 36 percent, while Argentina's increases amounted to a doubling of that market from I believe 48 percent.

And perhaps the hardest case of all is that of communist China. Last year, the communist Chinese received a $50 million loan from the International Development Association at less than 1 percent interest rates, and the purpose of that loan was to stimulate livestock and citrus production and, unfortunately, it certainly did that. As a consequence, U.S. imports of certain Chinese meat products have increased by 30 percent in the last year and a half. Meanwhile, the International Development Association received 25 percent of its contributions from the United States.

So these examples are only part of the story, but they are particularly relevant to my home state of Colorado and certainly to some extent to South Dakota because of the nature of our agricultural output. In 1984, Colorado ranked eighth among the states in total wheat production. It was among the leaders in livestock as well, including being number one in the total of sheep and lamb on feed, and we lead in a variety of other crops as well. Agriculture is vital to the economic health of our state. It's been one of the main-

stays for really ever since the state's inception in 1876 and I don't believe we can permit our farmers to suffer at the hands of other countries that don't play by the same rules and at the hands of international lending institutions, the lion's share of which contributions come from the United States, that support that kind of inequity.

Mr. Chairman, by opposing loans for commodities already in surplus and by requiring the lending institutions to oppose loans if export of those commodities would hurt U.S. producers I think we can perhaps not solve the agricultural crisis, but certainly go a long way to making sure that our farmers get a better shake. And by requiring the United States to reduce its contributions to these institutions when they promote those kinds of policies, this bill, FAIR, gives us the ability to take decisive action when the interests of the American farmer are threatened.

I think we all agree that America's farmers are second to none when it comes to ingenuity, when it comes to enterprise, when it comes to productivity. If we do our part to assure equity among our trading partners, America's farmers will get along certainly a lot better than they have been in the past. They already have shown that they can outproduce anyone and all they need is what we call a FAIR chance. Our bill is FAIR and it provides farmers with that chance. I heartily support its passage and I urge the committee and the Congress to support it as well, and I certainly thank you for your willingness to undertake this very important and worthwhile legislation.

Senator ABDNOR. Well, let me tell you, we thank you for coming over here and I know you're busy over in the House and that you came all the way across and I'm sure your farmers in Colorado appreciate it. I don't know how many farmers—I'm afraid they would riot if my people really understood, for instance, this one percent loan you speak of to China when they can't understand what it really does to them by giving them one percent. It's bad enough to be so generous, but to give it to them to compete against our farmers, I don't know how your people out in Colorado react, but I think more and more that they pay attention to this and I think we're going to hear a lot more from many farmers themselves.

Representative KRAMER. I agree. I think the initial reaction wherever I've thrown this out is so shocked, as it was mine before I knew about this, and after the shock the reaction got a little stronger.

Senator ABDNOR. Well, I thought I heard a proposal the other day talking about making a sizable loan either to Brazil or Argentina where apparently they put an export tax on the grain and they think that's too harmful to the markets that way, that extra cost, so we're going to help them eliminate that or something and I guess that's about the way this operates.

What percentage do we have in the Bank? One-third of the dollars that go out on loans come from the U.S. Treasury? How much is that?

Representative KRAMER. I think our total international lending institutions contribution today is about $1 billion and of all the money that these institutions get, we contribute generally in the

range of 20 to 30 percent of the total amount of money these institutions receive.

Senator ADBNOR. Well, I have enough problems here with my farmers trying to keep things shored up and speak out for them, but if they really realized what they're up against, it would be very discouraging for them.

Hopefully, we're going to get our story told. Number one, when we're already in debt like we are, we hardly have any money to loan anyone else, and maybe we're going to have to look elsewhere to fight this sort of thing. I think I'm beginning to believe the Department of Agriculture is on our side. I have had some testimony in other committees and in the Joint Economic Committee on this where we got into this subject, and it isn't in the Department of Agriculture where we've got to fight it. It must be some other agencies that feel so strongly about this. But we're working together with you and with your strong support, I hope there are better days ahead.

Representative KRAMER. Well, thank you. I appreciate your interest and I really believe that the key to this bill are the sanctions provided. The teeth comes in the amount of our contributions and I think we'll get the message across.

Senator ABDNOR. I think they'll get the message. Well, thank you very much.

Representative KRAMER. Thank you.

Senator ABDNOR. Our next witness is—I'm going to ask a group of four to come up here and we can ask questions all at the same time, Naioma Benson who is president of Women Involved in Farm Economics; Professor Robert Paarlberg, Watertown, Massachusetts; Mr. William Galston, director of the economic and social programs of the Roosevelt Center; and our last witness is Mr. Stuart Hardy, manager of the food and agricultural policy of the Chamber of Commerce.

Ladies and gentlemen, we appreciate you coming forward and participating. Thank you all for your participation. Joe Cobb is going to take over for a little bit. I just have to go take care of something and I will be back.

Mr. COBB. Mrs. Benson, if you would proceed with your statement, please.

## STATEMENT OF NAIOMA BENSON, NATIONAL PRESIDENT, WOMEN INVOLVED IN FARM ECONOMICS

Mrs. BENSON. Mr. Chairman, members of the subcommittee, I commend you for calling this hearing on a vital issue of the proposed reform of foreign agricultural investment priorites. I appreciate this opportunity to appear before the subcommittee and share the views of National Women Involved in Farm Economics or WIFE.

I am Naioma Benson from Sterling, Colorado. For the past 25 years, my husband and I have had a hard red winter wheat and cattle operation in the northeastern portion of Colorado. I have been serving as National President of WIFE since January 1985 and have been active in the organization since it began ten years ago.

The members of National WIFE are farm and ranch women who are daily living the problems of production agriculture in the United States. Our lives, those of our husbands and our children, and their futures, depend upon agriculture. We have a stake in agricultural policy, agricultural credit policy, and trade policy.

The agricultural policy set forth in the 1985 farm bill was designed to make American producers more competitive. We as producers are willing to cut our production and participate in government programs. We are following responsible practices to eliminate the surpluses. We have tolerated the lowering of loan and target prices as an attempt to be more competitive in the world market. We are giving and giving and giving, and going the extra mile to bring profit back to our farming operations.

Yet, as we cut our production and our income, foreign countries are encouraged to increase their production. That encouragement comes in the form of loans through multilateral banks. These loans are directed at increasing foreign agricultural production.

Foreign agricultural producers have a twofold advantage over us as American farmers: Their governments subsidize their producers; and their governments' ability to borrow from the World Bank at minimal interest rates. These banks have portions of their funding coming from our taxpayers.

Loans to foreign countries are often long term and almost interest-free. Agricultural loans in the U.S. to our farmers are unduly high when compared to those loans made to our competitors. We see Farmers Home Administration loan rates at 8 to 9 percent; Federal Land Bank loans at 10 to 12 percent; and commerical lenders at 12 to 14 percent. It is apparent that farmers and ranchers in the United States are being forced out of business by these interest rates, yet our country's contribution to an international financial institution provides for low-interest loans.

Farmers, ranchers, consumers, and all of us as taxpayers must ask: How many U.S. farmers would not have been forced out of business if they too had had the advantage of these low-interest loans? This double standard does not provide justice for all.

We must question at what point does the U.S. Government and its policies protect its own agricultural producers and its citizens. When does it give its citizens priority over foreign countries and their agricultural producers? How long must we tolerate the financing of our competition? How can the 1985 farm bill make us more competitive when U.S. tax dollars are thrown out for our foreign competitors?

For many years, producers have conducted their own self-help programs. They have used commodity check-off programs for product promotion and export development programs. They have supported research to improve the quality and safety of their products. Not only have these programs created a market for our products, but they have created jobs for citizens of this country.

As a wheat producer from Colorado, we have seen the past and the positive effect in our community of a bountiful crop at a fair profit. A study titled "American Wheat at Work" prepared by Oklahoma State University, indicates that six non-farm jobs are created by each farm worker. The study also indicated that 124.7 jobs are created for every million bushels of wheat exported. The

jobs of American laborers are dependent on exports of our commodities. Our decrease of exports reduces the number of potential jobs in our country. U.S. trade policy seems willing to sacrifice productivity in our country to increase production abroad. This foreign production is often the very commodity produced in surplus in competition with ours.

We believe that the 1985 farm bill was to have improved exports. As agricultural producers, we made concessions in portions of the farm bill that would have meant immediate improvement in our financial status. We made these concessions in return for export enhancement programs. Yet to date we have seen little or nothing done to improve exports. In fact, our government agencies report that exports will continue to lag during 1986 and into 1987.

It appears contradictory to promote agricultural export on one hand and, on the other, to finance at minimal interest rates, foreign competition. It is as though one hand does not know or care what the other is doing. Why should foreign countries import their commodities when they can receive low interest loans to begin their own export production machine?

These lending policies are having a devastating effect on our country. I would like to offer you my views of what we are seeing and feeling in rural America. I bring my opinions to you as a farmer and rancher. The future of my family directly depends upon agricultural policy. The price of our commodity and the amount of it exported determines our income. We have no guaranteed income that is stable, plus the cost of living rise whether the farm bill proves to be good or bad or whether imports increase or decrease. I do not bring my views as a paid executive director or lobbyist. This position I hold is one of volunteer, totally committed to what is right for the American farmers and ranchers of rural America.

I see what is happening in my community, but I also have the unique opportunity to travel to twenty organized WIFE state associations. Since January, I have stayed in the homes of our members in Alabama, South Carolina, Missouri, Indiana, and Washington State. I have visited local chapters in Minnesota, Colorado, Nebraska, and Wyoming.

The story is the same across the entire country—foreclosure, bankruptcy and Chapter XI. Our farm women are being forced to look for work off the farm, but often in their small remote communities there is no work. To be paid a minimum wage is indeed a premium. We are seeing in our area women driving 20 to 25 miles to work four to six hours a day. They are gaining a feeling of contributing to their declining income by working off the farm only 20 to 30 hours a week.

It is an ironic fact that farmers and ranchers are withdrawing within themselves. Farm organization after farm organization is finding that they are not able to encourage people to attend meetings and to talk openly about their problems. We have been told by Members of Congress that they assume the situation in rural America is improving considerably because they are not hearing from their constituents. I must assure you and this subcommittee that the situation grows worse daily. A sense of no one truly cares

and no one will do anything to change the situation abounds. The moral fiber of rural America is rapidly deteriorating.

The proposed reform of the foreign agricultural investment priorities would be a positive change in ag policy. We welcome and support the Foreign Agricultural Investment Reform Act. It would be one of the most beneficial steps toward assisting American farmers and agribusiness. It will have the support in rural America and give them hope that other approaches are being used to eliminate world surplus.

A change of policy toward lending to foreign countries who produce commodities in surplus with ours would also send a positive signal to the world. It would say that the United States does believe in the value if its agricultural producers and the importance of agriculture to our entire economy. Thank you very much.

Mr. COBB. Thank you very much, Mrs. Benson, for your testimony. Mr. William Galston, will you proceed with your remarks.

## STATEMENT OF WILLIAM A. GALSTON, DIRECTOR, ECONOMIC AND SOCIAL PROGRAMS, ROOSEVELT CENTER FOR AMERICAN POLICY STUDIES

Mr. GALSTON. My name is William Galston. I am director of economic and social programs at the Roosevelt Center for American Policy Studies, a nonpartisan public policy center located here in Washington.

I should note at the outset of my remarks that by law the Roosevelt Center is prohibited from commenting on specific pieces of legislation.

For over two years, the Roosevelt Center has sponsored a Food and Agriculture Policy Project designed to explore new competitive realities and policy alternatives in this critical sector. Last year we began to analyze the impact of the international debt crisis, especially its Latin American component, on agriculture and other aspects of our economy. Quite frankly, we were surprised by what we found. The effects of this crisis, we concluded, are far more serious than is generally understood. These effects include: declining U.S. exports; falling commodity prices; increased foreign competition with U.S. producers across a wide range of agricultural commodities, minerals, and manufactured goods; and last but surely not least, U.S. job losses of between 800,000 and 1.4 million over the past four years.

In short, while the overvalued dollar has usually taken the rap alone, the international debt crisis is the most unindicted co-conspirator in this continuing assault on U.S. farmers, workers, and manufacturers.

The Roosevelt Center's findings closely parallel those of the Joint Economic Committee staff report made public just last week and thus I need not dwell on the details. I would like, however, to stress one key point. For four years, since the onset of the debt crisis, U.S. policy has encouraged—indeed, pushed—debtor nations to service their loans through increased exports. In circumstances of global oversupply and slack demand for most commodities, this strategy has proved largely self-defeating. As debtor nations have boosted the volume of their production and exports, already de-

pressed prices for minerals and agricultural products have been forced down still further. As a result, the value of their exports has not risen commensurately, and in some cases it has actually fallen. Thus, debtor nations have not appreciably increased their capacity to service their loans. Throughout Latin America, in fact, every single debtor nation has increased its external debt more rapidly than its export revenues.

Let me give you just a few examples. Over the past five years, Brazil increased its export volume by 56 percent, but its export revenues rose only 25 percent, while external debt rose 33 percent.

Mexico increased export volume by 62 percent, but export revenues by only 34 percent, while debt rose 41 percent.

Argentina increased export volume by 47 percent, but revenues rose by barely 3 percent, while debt soared 46 percent.

Chile increased export volume by 21 percent, but export revenues actually fell by 23 percent, while debt rose 43 percent.

In spite of four years of stringent domestic austerity and international export promotion, debtor nations are not on a path to recovery and growth; they are on a treadmill to exhaustion and despair. This, we believe, is the perspective from which future international loans for increased commodity production should be viewed.

Let me conclude with a broader point which I think provides the context for today's discussion. It is easy to understand and appreciate the desire of U.S. policymakers to shore up the shaky international financial system. But whatever the intention of U.S. international policy since 1982, its effect has been to emphasize financial sector profits at the expense of U.S. farmers, workers, and manufacturers—and, it should be added, the poorest citizens of debtor nations as well.

In our judgment, the time has come to reconsider current policy, which has focused on maximizing repayment of troubled loans. The time has come to ask whether this policy is really conducive to the long-term stability of the financial system, and whether it best promotes the key goals of balanced economic growth at home and the stabilization of democratic institutions abroad. And the time has come to explore alternative approaches for regulatory and other policies that would minimize the effects of such relaxation on domestic financial institutions. For unless their is a significant change in current policy, pressure on debtor nations to boost exports—whatever the cost—will only intensify, with increasingly serious consequences for both embattled U.S. producers and fragile foreign democracies.

I thank this subcommittee very much for this opportunity to share our views with you.

[The prepared statement of Mr. Galston follows:]

PREPARED STATEMENT OF WILLIAM A. GALSTON

My name is William Galston, and I am Director of Economic and Social Programs at the Roosevelt Center for American Policy Studies, a nonpartisan public policy center located here in Washington. On behalf of the Roosevelt Center, I would like to thank the Chairman of this subcommittee for giving us this opportunity to share the results of our research with you.

By law, the Roosevelt Center is prohibited from commenting on specific pieces of legislation. In addition, it is our policy to refrain from advocating specific solutions to policy problems. Instead, we conduct impartial analyses of these problems and of the major options for addressing them, and we seek to increase citizen participation in policy deliberations.

For over two years, the Roosevelt Center has sponsored a Food and Agriculture Policy Project designed to explore new competitive realities and policy alternatives in this critical sector. Last year we began to analyze the impact of the international debt crisis--especially its Latin American component--on agriculture and other aspects of our economy. We were surprised by what we found. The effects of this

crisis, we concluded, are far more serious than is generally understood. They include:

- o declining U.S. exports;
- o falling commodity prices;
- o increased foreign competition with U.S. producers across a wide range of agricultural commodities, minerals, and manufactured goods; and
- o U.S. job losses of between 800,000 and 1.4 million over the past four years.

In this context, one of the most significant developments is the rapid substitution of Latin American agricultural exports for U.S. exports in third-country markets. For example, during the 1980/1981 crop season, world wheat exports were 94.1 MMT, of which the U.S. supplied 41.9 MMT and Argentina, 3.9 MMT. By the 1984/1985 season, world exports had risen more than 10 percent. U.S. exports, however, had fallen by almost 10 percent (3.8 MMT) while Argentina's had more than doubled.

The story for soybeans is even more dramatic. Between 1981/1982 and 1984/1985, world soybean exports declined by 4.4 MMT, or 15 percent. U.S. soybean exports fell by 9 MMT--

36 percent. Meanwhile, Brazil's soybean exports were quadrupling and Argentina's were doubling. Together, they now constitute 27 percent of the world soybean market, up from only 18 percent at the beginning of the decade. Soybean meal presents a similar picture. As world export volume was rising by 10 percent, U.S. exports were falling by one-third, while Argentina's exports quadrupled.

In short: while the overvalued dollar has usually taken the rap alone, the international debt crisis is the unindicted co-conspirator in the continuing assault on U.S. farmers, workers, and manufacturers.

The Roosevelt Center's findings closely parallel those of the Joint Economic Committee report issued just last week, and I need not dwell on the details. I would like, however, to stress one key point. For four years, U.S. policy has encouraged--indeed, pushed--debtor nations to service their loans through increased exports. In circumstances of global oversupply and slack demand for most commodities, this strategy has proved largely self-defeating. As debtor nations have boosted the volume of their production and exports, already depressed prices for minerals and agricultural prodcuts have been forced down still farther. As a result, the value of their exports has not risen commensurately, and in some cases it has actually fallen. Thus, debtor nations have not appreciably increased their capacity to service their

loans. Throughout Latin America, every single debtor nation has increased its external debt more rapidly than its export revenues.

Let me give you a few examples.

o Over the past five years, Brazil increased its export volume by 56 percent, but its export revenues rose only 25 percent, while external debt rose 33 percent.

o Mexico increased export volume by 62 percent, but export revenues by only 34 percent, while debt rose 41 percent.

o Argentina increased export volume by 47 percent, but revenues rose by barely 3 percent, while debt soared 46 percent.

o Chile increased export volume by 21 percent, but export revenues actually fell by 23 percent, while debt rose 43 percent.

In spite of four years of stringent domestic austerity and international export promotion, debtor nations are not on a path to recovery and growth; they are on a treadmill to exhaustion and despair. This, we believe, is the perspective from which future international loans for increased commodity

production should be viewed.

Let me conclude with a broader point. It is easy to understand and appreciate the desire of U.S. policymakers to shore up the shaky international financial system. But whatever the intention of U.S. international debt policy since 1982, its effect has been to emphasize financial sector profits at the expense of U.S. farmers, workers, and manufacturers--and, it should be added, the poorest citizens of debtor nations. In our judgment, the time has come to reconsider current policy, which has focused on maximizing repayment of troubled loans. The time has come to ask whether this policy is really conducive to the longterm stability of the financial system, and whether it best promotes the key goals of balanced economic growth at home and the stabilization of democratic institutions abroad. And the time has come to explore alternative approaches for relaxing pressures on Third World debtors, along with regulatory and other policies that would minimize the effects of such relaxation on domestic financial institutions. For unless there is a significant change in current policy, pressure on debtor nations to boost exports--whatever the cost--will only intensify, with increasingly serious consequences for both embattled U.S. producers and fragile foreign democracies.

TABLE 1

Trends In U.S. Farm Exports, 1977-1985

| | Volume (MMT) | Value (billions of dollars) |
|---|---|---|
| 1977 | 111.9 | 24.0 |
| 1978 | 131.9 | 27.3 |
| 1979 | 137.4 | 32.0 |
| 1980 | 163.9 | 40.5 |
| 1981 | 162.6 | 43.8 |
| 1982 | 157.9 | 39.1 |
| 1983 | 144.8 | 34.8 |
| 1984 | 143.6 | 38.0 |
| 1985 | 125.7 | 31.2 |

Source: Congressional Research Service, Patterns in Trade of Selected U.S. Agricultural Exports, Report #86-510 ENR, January 30, 1986, Table 2 and 3.

TABLE 2

Trends in U.S. Exports of Selected Commodities, 1980-1985

| | Wheat | | Coarse Grains | | Soybeans | |
|---|---|---|---|---|---|---|
| | Value | Volume | Value | Volume | Value | Volume |
| 1980 | 6.5 | 37.0 | 9.1 | 72.3 | 10.0 | 32.2 |
| 1981 | 9.6 | 43.1 | 10.4 | 70.3 | 9.4 | 26.8 |
| 1982 | 7.7 | 45.3 | 7.0 | 57.9 | 9.5 | 32.7 |
| 1983 | 6.2 | 38.2 | 6.6 | 53.8 | 8.9 | 31.8 |
| 1984 | 6.8 | 42.8 | 8.2 | 55.6 | 8.8 | 24.9 |
| 1985 | 4.4 | 29.3 | 6.9 | 55.2 | 6.4 | 21.9 |

Source: Same as Table 1.

Table 3

Changes In Export Volume, Export Revenues, and External Debt, 1980-1985

| | % change Volume of exports 1980-1985 | % change Export revenues 1980-1985 | % change in total external debt 1980-1985 |
|---|---|---|---|
| Argentina | 47 | 3 | 46 |
| Bolivia | -35 | -38 | 31 |
| Brazil | 56 | 25 | 33 |
| Chile | 21 | -23 | 43 |
| Dominican Republic | 8 | -17 | 33 |
| Ecuador | 39 | 9 | 37 |
| Mexico | 62 | 34 | 41 |
| Peru | -3 | -24 | 30 |
| Uruguay | 1 | -20 | 57 |
| Venezuela | -21 | -25 | 13 |

Source: Economic Commission for Latin America, Preliminary Overview of the Latin American Economy 1985, Santiago, December, 1985, Table 7 and Table 15.

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Alfred J. Watkins, Till Debt Do Us Part: Who Wins, Who Loses, and Who Pays for the International Debt Crisis. (University Press of America, 1986)

Alfred J. Watkins and William A. Galston, "International Debt, Domestic Credit, and the Rural Economy." Delivered at the Aspen Institute Seminar on Rural Economic Policy, May 6, 1986.

Mr. COBB. Thank you very much, Mr. Galston. Mr. Paarlberg, will you proceed with your statement.

**STATEMENT OF ROBERT L. PAARLBERG, ASSOCIATE PROFESSOR OF POLITICAL SCIENCE, WELLESLEY COLLEGE, AND ASSOCIATE, HARVARD UNIVERSITY CENTER FOR INTERNATIONAL AFFAIRS**

Mr. PAARLBERG. I would like to thank the subcommittee for inviting me to add my perspective to these important hearings. I am talking in my capacity as a scholar and a private citizen and I think you will find my views differ a bit from those you have been hearing so far.

Whenever multilateral lending agencies like the World Bank and the IMF provide support for agricultural development in poor countries, strong objections are raised by organized farm interests here in the U.S. These interests ask, as they have been asking this afternoon, with so many U.S. farm producers currently in trouble, either for lack of new lending or due to stiff international competition, why should our tax dollars be going into new farm lending abroad which only builds up that competition?

If the concerns of the U.S. farm interests are to be met, the answer to this question should go beyond a simple assertion that U.S. taxpayers have some moral obligation to support agricultural development in poor countries and arguments about what might be good for U.S. bankers or what might be good for U.S. diplomatic interests should also be for the moment at least set aside. These larger arguments may have validity. I happen to believe that they do. But they have the unfortunate effect of leaving U.S. farmers with the impression that their interests are being sacrificed. Fortunately, for U.S. farm interests I believe this impression is unjustified.

My purpose today will be to argue that even if we set aside our moral interests, our financial interests, and diplomatic interests, and even if we look only at what is good for U.S. agriculture, using tax dollars to promote farm development in poor countries is still good policy. The logic behind this somewhat paradoxical assertion becomes clear when we observe that farm development in poor countries produces not only a larger local food supply; it also produces much larger local food demands. This is because agricultural development in poor countries usually stimulates broad-based income growth, and in poor countries most additional income is spent to consume food.

Now it is true that there exists an enormous unrealized potential to produce food. That frightens U.S. farm operators. But there also exists, within these same poor countries, and even larger unrealized potential to consume food. The best way to turn this consumption potential is to stimulate income growth and the best way to do that is through farm development.

Much of the unrealized potential to consume (and hence to import) more food in poor countries grows out of an unsatisfied demand for diets rich in high quality foodgrains and livestock products, such as meat, milk, and eggs. I remind you that U.S. agriculture is a highly competitive supplier of low-cost animal feedstuffs,

which even poor countries begin to import when they begin their response to internal dietary enrichment demands. It is therefore not surprising to see U.S. farm exports grow, rather than shrink, in response to farm development driven income growth in poor countries.

Of course, if suspicious U.S. farm organizations are to be convinced of this important indirect relationship between enlarged farm production in poor countries and enlarged U.S. farm exports, they will have to see some evidence that goes beyond a few dramatic but perhaps exceptional East Asian miracle cases and, fortunately, now we have a number of broadly based studies which can supply the confirming evidence that we need.

In my prepared statement I provide detailed summaries of four separate studies undertaken over the past several years the existence of a positive relationship between farm production growth and farm import growth in most poor countries.

In the interest of time, I will simply refer you by name to the authors of these four studies. The first is a study undertaken at the International Food Policy Institute here in Washington, D.C. by Kenneth L. Backman and Leonardo Paulino entitled "Rapid Food Production Growth in Selected Developing Countries: A Comparative Analysis of Underlying Trends." That's an October 1979 study.

The second study which I detail in my prepared statement is a more recent USDA study by John Lee and Mathew Shane, a June 1985 study, entitled "U.S. Agricultural Interests in Growth and Developing Economies: The Critical Linkage."

The third study which I described is by Earl Kellogg at the Consortium for International Development in Arizona, a May 1985 study.

The fourth study is by Richard Kodl, an agricultural economist, at the Univeristy of Illinois, now at the U.S. Department of Agriculture.

What each of these studies confirms is that rapid farm growth in poor countries will produce an immediate gain for U.S. farm exports.

Now of course these are findings of aggregate tendencies so they should not be taken to mean that in every single case rapid farm growth in poor countries will produce an immediate gain for U.S. farm exports. We know that in some recent cases—for example in the case of China over the last several years—record farm production gains can get out ahead of domestic income growth, and out ahead of dietary improvement, and also out ahead of the desired farm trade policy and the result can be a short-term drop in farm imports. We also know that in some other poor countries—for example, Egypt—farm imports can grow despite an absence of rapid internal farm development. Egypt imports products such as wheat and wheat flour precisely to make up for the poor performance of its own farm sector. So in the complex world of national and international farm markets, many different development paths can lead to the same trade outcome, and the pursuit of one development path in different countries can even lead to different trade outcomes. Those of us who are concerned with these issues should therefore be careful when we generalize. We should examine each individual case on its own terms and in its own proper context.

But this is precisely why I must oppose the rigid formula restrictions on multilateral farm lending contained in S. 1810. Instead of encouraging multilateral lending agencies to judge farm development loans in context, on a case-by-case basis, this legislation imposes inflexible restrictions on all cases. The result is to threaten not only the minority of multilateral farm loans which might be objectionable, but also the vast majority which are on balance to U.S. farm trade expansion. If, as my evidence has shown, agricultural development in most poor countries has been good for most U.S. farmers, and expecially U.S. farm exporters, then the bias in this legislation against lending for agricultural development must be judged harmful.

There is an effort made, within the language of the legislation, to oppose only those loans to poor countries which might encourage the production of agricultural commodities for export, and only when a surplus of such commodities exists in world markets, and only when some competing U.S. agricultural producers would stand to be harmed by such exports. Unfortunately, even with these well-intentioned qualifications, the bill in its present form remains much too restrictive. For example, these seemingly innocent criteria would rule out any further multilateral support for tropical sugar production.

Sugar, which is most efficiently produced in tropical countries, remains a key ingredient in the growth plans of more than a dozen poor countries, from the Caribbean Basin to the Philippines. Many of these sugar producing countries are good customers for U.S. farm exports. I hope it is not the intent of this legislation to render the farm growth plans of these poor countries unworkable, thus jeopardizing not only their welfare and their political stability, but also their ability to purchase U.S. farm products. If the real intent is simply to protect our own relatively inefficient domestic sugar industry, I would submit that this is already being done, probably to excess, by other legislative means.

These seemingly innocent criteria would also appear to rule out any further multilateral support for basic food grain production in some large developing countries, such as India, which has emerged as an occasional net exporter of wheat and rice due to momentary and purely regional surplus accumulations. Should it be the policy of the U.S. Government to oppose the production of basic food grains in India, where several hundred million poor citizens, most of them underemployed farmers, are still suffering from chronic malnutrition? Once again, I hope this is not what the authors of this legislation had in mind.

As a concluding thought, if the purpose of this legislation is to look for ways to discourage the production and export of subsidized surplus farm products, I would suggest that the poorest developing countries ought not to be the focus of our attention. These days, it happens to be an association of rich countries—the European Community—which is doing the most to glut world markets (including wheat and sugar markets) with high-cost subsidized surplus production. It would be too bad if it became the policy of the U.S., through the legislation being considered here, to punish poor farmers in poor countries for these market distortions which are being perpetrated primarily by rich farmers in rich countries.

I agree with the authors of this legislation that the subsidized growth and the subsidized export of inefficient farm production represents a threat to efficient farm operators in the United States, and is therefore not deserving of taxpayer support. But I disagree with the decision to attack this problem by placing new restrictions on the lending activities of multilateral agencies in poor countries. Within most poor countries today, the investments being made in agriculture are still too few. It is primarily among the rich countries—including perhaps the United States as well as the European Community—that the growth of inefficient and highly subsidized farm production seems instead to be going out of control. Here, I submit, is where the heaviest burden of "fair" agricultural investment reform ought to lie.

I thank you for the opportunity to make my views known.

[The prepared statement of Mr. Paarlberg follows:]

PREPARED STATEMENT OF ROBERT L. PAARLBERG

AGRICULTURAL DEVELOPMENT IN POOR COUNTRIES:
POTENTIAL GAINS FOR U.S. FARM EXPORTS

Whenever multilateral lending agencies like the World Bank and the IMF provide support for agricultural development in poor countries, strong objections are raised by organized farm interests here in the U.S. With so many U.S. farm producers currently in trouble, either for lack of new lending or due to stiff international competition, why should our tax dollars be going into new farm lending abroad which only builds up that competition?

If the legitimate concerns of U.S. farm organizations are to be met, the answer to this question must go beyond a simple assertion that U.S. taxpayers have some moral obligation to promote agricultural development in poor countries. Arguments about what might be good for U.S. banks or U.S. diplomats must also, for the moment, be set aside. These larger arguments may be valid -- I believe they are -- but they have the unfortunate effect of leaving U.S. farmers with the distinct impression that their own specific interests are nonetheless being sacrificed.

My purpose today will be to argue that even if we set aside our moral, financial, and diplomatic interests, and even if we look only at what is good for U.S. agriculture, using tax dollars to promote farm development in poor countries is still good policy. I will first lay out the logic behind this

paradoxical assertion, then I will review the evidence which supports that logic.

The logic behind this assertion becomes clear when we observe that farm development in poor countries produces not only a larger local food supply; it also produces much larger local food demands. This is because agricultural development in poor countries usually stimulates broad-based income growth, and in poor countries most additional income is spent to consume food.

Among today's poor countries, it is true that there exists an enormous unrealized potential to produce food. That frightens some U.S. farm operators. But there also exists, within these same poor countries, an even larger unrealized potential to consume food. The best way to turn this consumption potential loose is to stimulate income growth, and the best way to do that is through farm development.

Much of the unrealized potential to consume (and hence to import) more food in poor countries grows out of an unsatisfied demand for diets rich in high quality foodgrains and livestock products, such as meat, milk, and eggs. I remind you that U.S. agriculture is a highly competitive supplier of quality foodgrains, and by far the world's most competitive supplier of low-cost animal feedstuffs, which even poor countries begin to import when they begin their response to internal dietary enrichment demands. It is therefore not surprising to see U.S. farm exports grow, rather than shrink, in response to farm development driven income growth in poor countries.

Of course, if suspicious U.S. farm organizations are to be convinced of this important indirect relationship between enlarged farm production in poor

countries and enlarged U.S. farm exports, they will have to see some evidence. And this evidence will have to go beyond a few dramatic but perhaps exceptional East Asian "miracle" cases, such as South Korea or Taiwan. Fortunately, we now have a number of more broadly based studies which can supply the confirming evidence we need.

I refer you first to a study done in 1979 for the International Food Policy Research Institute here in Washington, by Kenneth Bachman and Leónardo Paulino, which examined the trade consequences of rapid food production growth in sixteen developing countries, and found that while the proportion of domestic food consumption satisfied by imports generally fell in these countries, net imports of staple foods nonetheless increased, to the presumed benefit of U.S. agriculture. Bachman and Paulino found that annual net staple food imports in these agriculturally successful poor countries actually rose in volume by 133 percent between 1961-65 and 1974-76.[1]

In a more recent USDA study by John Lee and Mathew Shane, similar results were found in two specific developing countries which are presumed by many U.S. agriculturalists to be among their most direct competitors -- Malaysia and Brazil. Lee and Shane found that both of these countries responded to rapid agricultural development between 1967 and 1983 by increasing farm imports along with farm exports. On a wheat equivalent basis, Malaysia's imports of food, feed grains, and oilseeds (primarily U.S. soybeans) increased

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1. Kenneth L. Bachman and Leonardo A. Paulino, RAPID FOOD PRODUCTION GROWTH IN SELECTED DEVELOPING COUNTRIES: A COMPARATIVE ANALYSIS OF UNDERLYING TRENDS,1961-76, International Food Policy Research Institute, Research Report 11, October 1979, p.14.

from 1 million tons to almost 2.4 million tons during this period. Brazil showed a similar pattern. In spite of its noteworthy success in boosting farm production and farm exports, Brazil at the same time became a significant agricultural importer (of grains in particular). Lee and Shane conclude that "contrary to what seems to follow from common sense reasoning, economic development in the developing countries along comparative advantage lines is not competitive with [U.S.] export interests, but generally complementary to it."[2]

An even more recent 1985 study by Dr. Earl Kellogg of the Consortium for International Development in Arizona reaches similar conclusions. This study examines per capita changes in agricultural imports in 18 significant developing countries (out of 92) which exhibited the most rapid growth in per capita food production, over the period 1970-1980, and it compared these changes to those in 13 countries which exhibited the least rapid food production growth. The data reveal that this first category of agriculturally successful developing countries increased its dollar value of per capita agricultural imports by 47 percent, compared to only a 37 percent increase among the second group of agriculturally unsuccessful countries. In other words, food imports from countries such as the U.S. go up faster when poor country farmers are doing well and making money, than when they are doing poorly and losing money.

This same study also looks at specific cases by comparing the trade patterns

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2. John E. Lee, Jr. and Mathew Shane, "United States Agricultural Interests and Growth in the Developing Economies: The Critical Linkage," ERS, USDA, June 1985, p. 16

of two agriculturally successful developing countries (Brazil and Korea) to those of a much less successful counterpart (Sierra Leone). It finds that in the former case the volume of U.S. farm sales to Brazil and to Korea increased by an average of 8.7 percent and 6.7 percent per year respectively, between 1970 and 1983, while the volume of U.S. farm sales to Sierra Leone actually decreased at a 2.5 percent annual rate. Kellogg concludes that "in the intermediate term increases in agricultural production in developing countries do not have a negative impact on aggregate U.S. agricultural exports to these countries."[3]

A more sophisticated 1985 study by Richard Kodl at the University of Illinois, amplifies Kellogg's findings. Using a regression analysis with time series and cross sectional data on 77 developing countries, Kodl finds no significant negative correlation between per capita agricultural production in developing countries and their per capita imports of agricultural products. In six of thirteen equations, in fact, he finds a significant positive correlation. Kodl's examination of Kellogg's same specific country cases further confirmed the aggregate tendency for farm growth in poor countries to actually stimulate food import growth.[4]

These findings of "aggregate tendencies" should not be taken to mean that in every individual case rapid farm growth in poor countries will produce an

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3. Earl Kellogg, "University Involvement in International Agricultural Development Activities: Important Issues for Public Education," speech given at the 1985 Annual Meeting of the Association of U.S. University Directors of International Agricultural Programs, Athens, Georgia, May 31, 1985, p. 135

4. Richard Kodl, Masters Thesis, Department of Agricultural Economics, University of Illinois, 1985

immediate gain for U.S. farm exports. We know that in some recent cases -- for example, in the case of China over the last several years -- record farm production gains can get out ahead of domestic income growth, and out ahead of dietary improvement, and also out ahead of the desired farm trade policy adjustments. In such cases, a short term drop in farm imports is observed. We also know that in some other poor countries -- for example, Egypt -- farm imports can grow despite an absence of rapid internal farm development. Egypt imports products such as wheat and wheat flour precisely to make up for the poor performance of its own farm sector. So in the complex world of national and international farm markets, many different development paths can lead to the same trade outcome, and the pursuit of one development path in different countries can even lead to different trade outcomes. Those of us who are concerned with these issues should therefore be careful when we generalize. We should examine each individual case on its own terms and in its own proper context.

But this is precisely why I must oppose the rigid formula restrictions on multilateral farm lending contained in S.1810. Instead of encouraging multilateral lending agencies to judge farm development loans in context, on a case by case basis, this legislation imposes inflexible restrictions on all cases. The result will be to threaten not only the minority of multilateral farm loans which might be objectionable, but also the vast majority which are on balance beneficial to U.S. farm trade expansion. If, as my evidence has shown, agricultural development in most poor countries has been good for most U.S. farmers, and especially for U.S. farm exporters, then the bias in this legislation against lending for agricultural development must be judged harmful.

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of legislation have in mind.

As a concluding thought, if the purpose of this legislation is to look for ways to discourage the production and export of subsidized surplus farm products, I would suggest that the poorest developing countries ought not to be the focus of attention. These days, it happens to be an association of rich countries -- the European Community -- which is doing the most to glut world markets (including both wheat and sugar markets) with high-cost subsidized surplus production. It would be too bad if it became the policy of the U.S., through the legislation being considered here, to punish poor farmers in poor countries for these market distortions which are being perpetrated primarily by rich farmers in rich countries.

I agree with the authors of this legislation that the subsidized growth and the subsidized export of inefficient farm production represents a threat to efficient farm operators in the U.S., and is therefore not deserving of taxpayer support. But I disagree with the decision to attack this problem by placing new restrictions on the lending activities of multilateral agencies in poor countries. Within most poor countries today, the investments being made in agriculture are still too few. It is primarily among the rich countries -- including perhaps the U.S. as well as the EC -- that the growth of inefficient and highly-subsidized farm production seems instead to be going out of control. Here, I submit, is where the heaviest burden of "fair" agricultural investment reform ought to lie.

Mr. COBB. Thank you very much, Mr. Paarlberg. Mr. Hardy, would you proceed with your statement.

## STATEMENT OF STUART B. HARDY, MANAGER, FOOD AND AGRICULTURE POLICY, U.S. CHAMBER OF COMMERCE

Mr. HARDY. Thank you. I am Stuart Hardy, Manager, Food and Agriculture Policy, for the U.S. Chamber of Commerce. We appreciate this opportunity to comment on the FAIR legislation and, with your permission, I would like to submit the written prepared statement to the formal hearing record and I will just make very brief informal remarks.

Let me say right at the outset that the Chamber supports the thrust of this legislation and we agree that the U.S. should use its considerable leverage as the world's single largest shareholder in multilateral development banks to insist to certain reforms in lending practices. Specifically, we agree that in most instances it makes no sense to invest in the production of crops or commodities that are already in surplus supply on world markets. That kind of investment doesn't do the recipient country any favor.

The Chamber believes that the guiding principle in economic development should be that of comparative advantage. U.S. farmers and ranchers have little to fear and much to gain when a foreign country utilizes its comparative advantage with smart investments in sectors where that country can be competitive on a sustained basis without subsidization. The result is beneficial for the foreign country and its trading partners.

The problem, therefore, is not investments in foreign agriculture. The real problem is uneconomic investments in crops and commodities such as sugar cane in some instances where return on investment is totally inadequate and where the result is further disruption of world markets.

Investments should be based on sound economic criteria and not on political considerations, as is all too often the case now, particularly with some of the parastable organizations that are the recipients.

One such political consideration that has gained currency since the price shocks of 1972-73 era and has become strongly entrenched in the U.N., in multilateral banks, and in the planning agencies of developing countries, is the notion of food self-sufficiency. This is the, in my view, wrong-headed notion that nations should insulate themselves from world trade and use their limited resources to produce their own basic food requirements even though their cost of production may be far higher than that of other nations.

Recently, the Director of the Planning and Economic Analysis Division of the International Fund for Agricultural Development, IFAD, told an international fertilizer conference that "greater reliance on basic food self-sufficiency at both the national and regional levels must become an effective strategy for coping with the current problem." He was referring there to the problem of food shortages in the developing world.

He then went on to say that crop production in arid and semiarid regions of the Middle East and North Africa should become

more intensive. So IFAD recommends that developing nations should forsake trade and invest in domestic crop production even though in many instances they could buy the product cheaper than growing it themselves.

IFAD, by the way, is a U.N. agency and the U.S. pays about 25 percent of its budget.

There is ample evidence that those countries who use trade rather than the notion of food self-sufficiency as an engine of growth have been far more successful in developing their economies. For example, just yesterday, Mr. Mathew Shane—and one of his studies was just referred to by Mr. Paarlberg—Mr. Mathew Shane presented a paper in a conference at Purdue University showing comparative groups of developing nations whose policies favor trade with another group of comparable developing nations whose policies have tended to favor food self-sufficiency and reduced exposure to trade. The trading food importing nations, Shane concludes, have experienced a far stronger growth in GNP, a faster rise in per capita income, and less debt than the other nations.

But despite this evidence—and there's considerable evidence available—despite this evidence, the notion of food self-sufficiency persists and it's a very damaging policy not only for the U.S. farmers but also for the very nations that adopt such policies.

Let me conclude my remarks by underscoring just one other point we make in the prepared statement; and that is, namely, that multilateral development banks should place greater emphasis on working with the indigenous private sectors in developing nations. The World Bank is beginning to move in this direction and is also beginning to use its leverage to induce governments to adopt more market oriented policies, and we applaud this.

However, there is a long way to go on this. Private sector development is still not receiving the attention it deserves, including from our own Agency for International Development, which puts the bulk of its resources even in this the fifth year of the Reagan Administration into the public sector, into the parastables.

We feel the private sector development will pay far greater dividends in terms of world trade than loans to government projects that may be based more on domestic political considerations than on sound economic analysis.

That concludes my remarks and I thank you very much for the opportunity to testify today.

[The prepared statement of Mr. Hardy follows:]

## Prepared Statement of Stuart B. Hardy

I am Stuart B. Hardy, Manager, Food and Agriculture Policy, for the U.S. Chamber of Commerce. The U.S. Chamber is pleased to have this opportunity to comment on the "Foreign Agricultural Investment Reform Act." This legislation (S. 1810/H.R. 3643) raises pertinent issues about the effect on U.S. farmers and ranchers of subsidized agricultural loans made by multilateral development banks. The recently announced World Bank loan of $350 million to Argentina to enhance that country's farm export capability is a timely example of a pattern of controversial multilateral bank loans.

Multilateral banks are a major factor in world agricultural development. The largest of these banks, the World Bank and its affiliates, the International Development Association and the International Finance Corporation, funded 73 agricultural and rural development projects in 43 countries in Fiscal Year 1985 (FY'85) for a total of $3.7 billion. For many of those 43 recipient countries, agricultural exports are the most important source of foreign exchange, and many of the projects directly or indirectly will boost export volume.

The Chamber believes that the orderly expansion of the economies of developing countries is desirable because it engenders higher living standards and greater purchasing power in these countries and improved markets for U.S. international trade. However, the use of U.S. funds (public or private) in foreign economic development should take into account several important factors in each individual case. These factors include:

- o the establishment of political and economic security and equal justice for domestic and foreign traders;
- o access to essential raw materials, necessary capital (preferably private), whether domestic or foreign, and the requisite technical personnel;
- o the prospect of adequate markets for industrial products either at home or abroad;
- o the ability of industries thus fostered to survive without uneconomic trade barriers; and
- o operation by private enterprise rather than by government.

These five conditions should govern U.S. economic assistance to developing countries, whether such assistance is channeled through U.S. development agencies, such as the Agency for International Development, or through multilateral agencies in which the U.S. participates.

These conditions are not met always by the World Bank, the International Monetary Fund, or the regional development banks. In these instances, U.S. interests are undercut with U.S. dollars. Moreover, to the extent that uneconomic investments have been made in industries lacking comparative advantage, precious resources have been wasted and opportunities for genuine development have been lost.

World agricultural conditions have changed dramatically since the "food crisis" decade of the 1970's. Rather than food shortages, as many predicted, the 1980's have witnessed an unprecedented increase in world agricultural production, especially in the developing countries where a 38% increase in farm output has occurred since 1976.

Many developing nations, traditionally food importers, recently have become exporters. Indonesia, which five years ago was the world's largest rice importer, is looking for foreign markets to dispose of its three million metric ton surplus. India, a major importer in the 1970's, was a net farm exporter in 1985 and is forecasting record wheat and rice crops for 1986. Brazil, meanwhile, is stepping up its export capacity despite depressed world

commodity markets. Last year, Brazil's harvested acreage increased 15%, and the expansion continues with an additional 2.4 million hectares of land cleared for grain production in 1986. Perhaps the most striking example is the People's Republic of China, where farm production has increased by more than 50% since 1979 when the communes were disbanded and prices raised to incentive levels. Incidentally, all four of these countries received World Bank assistance for agricultural development in 1985.

In view of rising world farm output, sluggish demand, and depressed world commodity markets, one might question the continued high level of multilateral bank investment in agricultural development unless such projects genuinely are based on comparative advantage and possess solid, long-term prospects for sustainable return.

Related to the issue of cost-efficient investment is that of responsible resource development. There is ample evidence that multilateral lending institutions have not given adequate consideration to the long-term environmental effects of agricultural projects. For example, some projects have involved the destruction of vast tracts of tropical rain forests with potentially serious ecological consequences. Reflecting this concern, a task force of the Environmental and Energy Study Institute recently recommended that U.S. representatives to multilateral banks be instructed by Congress to oppose any project with environmental and natural resource impacts that undermine its long-term prospects for success. Congress addressed this issue in language included in the Foreign Assistance and Related Programs Appropriations Act for FY'86. However, you may wish to consider the inclusion of similar, permanent language in S. 1810/H.R. 3643.

This concern should not imply that the Chamber opposes multilateral bank funding of environmentally sound and economically efficient agricultural development projects. The multilateral banks are extremely important to the improvement of the international business environment and the health of developing nations' economies. Apart from all humanitarian and political concerns, the U.S. has a vested interest in the orderly economic growth of

developing nations. Clearly, the interests of the U.S. and other nations are best served when human, financial, and physical resources in all nations are employed in their most efficient uses.

Developing countries should be encouraged to focus development in sectors where they possess comparative advantage, including agriculture. For many developing countries with large farm populations, agricultural improvement is the most effective way of attaining rapid growth and higher income levels. Expanded food production raises farm income, generates job opportunities, improves diets, and frees labor for industrial development. The result is general economic growth and greater purchasing power.

It is agreed widely that the developing nations offer the best prospect for U.S. export market development. In many instances, projects, such as poultry and livestock expansion, actually have boosted U.S. export sales of feedstuffs, for example. In such cases, American farmers have little to fear and much to gain.

In this respect, the governing economic principle should be that of comparative advantage—the concept that wealth is generated most rapidly when persons and nations specialize in activities that they do best and trade freely with others who also so specialize. Regrettably, a rival concept—that of food self-sufficiency--increasingly has become entrenched among government planners and international agencies. This notion holds that nations should insulate themselves from possible global food price fluctuations by placing greater reliance on domestic production. Food self-sufficiency policies result in domestic farm subsidies, protectionism, high consumer costs, and resource misallocation. Such policies should not be encouraged by multilateral development banks.

Moreover, World Bank and other international loan programs should put more emphasis on lending funds to the indigenous private sector in developing countries. This would avoid the massive loan default problems we are currently facing due to loans being made to public sector firms that spend funds in a manner that places the decision in a political rather than an economic sphere.

At the present time, agricultural stocks in the U.S. and other exporting nations stand at record levels; commodity prices remain depressed; world trade growth has slowed dramatically; competition among exporters is fierce; and protective trade measures have proliferated. But these conditions are not irreversible. Recent developments offer hope that the U.S. can reclaim its competitive edge in agricultural trade. The sharp decline in U.S. nonrecourse loans for grain and oilseeds and marketing loans for cotton and rice enhances our competitiveness. A more favorable exchange rate and a drop in U.S. production costs will help also. The U.S. continues to possess a more efficient agricultural infrastructure than our competitors. World demand for farm products will continue to rise significantly due to population and economic growth.

The new round of General Agreement on Tariffs and Trade negotiations, commencing this September in Uruguay, offers another hope for substantially improving the world agricultural trading system and the U.S. role in that system. Perhaps the key challenge for policymakers in the U.S. and elsewhere is to reform domestic policies that impede agriculture in some countries and overstimulate it in others; to create a trading system in which comparative advantage plays a more important role in production and trade decisions; and to encourage market mechanisms that reduce the risks of participating in the system.

Thank you for this opportunity to present the Chamber's view on the "Foreign Agricultural Investment Reform Act."

Mr. COBB. Thank you very much. Thank you all for being here.

Senator Abdnor indicated as he departed that he would try to return as soon as he completed the engagements that he had to go to. I have here questions that he prepared that he would have asked. Let me proceed with his questions and then we'll carry the discussion beyond that.

I think you have an interesting diversity of views and I'd like very much to have an opportunity to have each of you comment on some of the points that were made by others of you.

Mrs. Benson, the Senator wants to thank you very much for your testimony. He agrees very much that something must be done about the farm credit problem in rural America and he would like to assure you that there are Members of this Congress that do care about the problems of the farm community.

He wished to ask—besides adopting the FAIR act, which you supported, what other recommendations do you have for helping improve our farm exports, specifically wheat exports?

Mrs. Benson. Certainly we would like to see the playing field leveled out so that where we export stands a fair chance with the European Economic Community and the subsidies there. We had hoped for so much more in the ag bill that the exports would be increased and the provisions made in it would see that they grew rapidly, and I feel the whole ag sector is very disappointed in that section of the farm bill.

Mr. COBB. We had hearings just two weeks ago which Senator Abdnor also chaired which looked at the European Economic Community's situation. We were shocked to realize that some European wheat farmers received $7 a bushel through their government.

You have traveled much around the country and talked to many representatives. What recommendations do you have for helping to improve the credit situation in rural America?

Mrs. Benson. The farm credit system currently is not being responsive at all to the needs of the producers. They were directed to negotiate their loans and to analyze them all one by one and they have not done this. We are seeing massive foreclosures where forebearance isn't being looked at and where they are not analyzing them one by one and they need to be directed again to do that.

Mr. Cobb. Thank you very much.

Mr. Galston, you argue that debtor nations are not on a path to economic recovery but on a treadmill to exhaustion and despair.

What alternative economic approaches would you recommend that the debtor nations follow?

Mr. GALSTON. I made that remark in the context of discussing their response to our international debt policy. They have embarked on a path of export promotion and export growth, in many cases not entirely voluntarily because in their judgment they are being pushed to do so and because that is the only way that they can hope to service their foreign loans at current terms and conditions.

There are many, many suggestions that have been heard in the past few months as to what they can do internally to improve their growth prospects and it seems to me, speaking purely personally, that many of those suggestions have merit.

It's the contention of my remarks and of the Roosevelt Center's studies, however, that the pressure to comply with current terms and conditions of international loans is making it very, very difficult for debtor nations, in spite of their best efforts, to resume a sustainable growth path and it is our judgment, as I said at the conclusion of my remarks, that it is time to reconsider the policies that are being imposed on them that are forcing them to dedicate such a huge proportion of hard currency and their export revenues toward debt service.

Until those policies are thoroughly reexamined and altered in significant respects, it would be extraordinarily difficult for them to get back on the growth path.

Mr. COBB. Do you have recommendations specifically—perhaps the Roosevelt Center or you personally—of things that can be done to alleviate the international debt crisis so that these nations can expand their economies? It's very clear, as you pointed out, that it's the necessity of making heavy debt service payments that is draining capital from these nations.

Mr. GALSTON. As indicated in my prepared statement, the Roosevelt Center institutionally refrains from offering specific programmatic proposals or suggestions.

Speaking personally, I thought many of the recommendations embodied in a staff report of the Joint Economic Committee issued last week headed in a very interesting and potentially productive direction.

There is a huge range of alternatives that could be considered, but they all have some central features in common. They will require, in many cases, stretching out loans; in many cases, negotiating interest rates downward; and in general these approaches are going to have to reduce the amount of annual debt service paid by debtor nations. Otherwise, no good will come of the renegotiation whatsoever.

And there are various technical considerations bearing on the appropriateness of different devices. Some are better suited to the current structure of the U.S. bank regulatory system than others. Some would require regulatory changes or reinterpretations of current regulations or compliance with current regulations. This gets into technical questions that I think I should best avoid at this juncture.

But to sum up, unless renegotiation policy reduces the annual principal and interest payment paid by debtor nations to their foreign creditors, they are going to have a very hard time making it in the current world economy.

Mr. COBB. Mr. Paarlberg, the Senator wanted to ask you specifically—you've argued that using tax dollars to aid development in poor countries is still a good policy.

Based on your findings, do you expect American farm exports to increase in the next year?

Mr. PAARLBERG. Whether U.S. farm exports increase or do not in the next year will have very little to do with the continuation or the discontinuation of multilateral lending agency assistance for foreign development in poor countries.

I believe Mr. Pope testified earlier that the volume of lending that would be constrained by this proposed legislation would be no

more than 5 percent of the multilateral lending agency total and that gets you down to a very small number and isn't going to make an enormous difference one way or the other in U.S. farm exports over the next twelve months.

If I just say, those of us who share a concern for the revivial of U.S. farm exports, for this very reason ought not to detain ourselves for too long with the problem of multilateral lending in poor countries. We should be paying more urgent attention to exchange rate relationships, to trading relationships, and trading disputes, especially with other rich countries, including the Japanese and the European Economic Community. We should be looking at manufactured trade. We should be looking at international financial institutions that have as their purpose not to support trade but to use the liquidity crisis that has made it impossible for our good customers to purchase our products.

If we do all of these things, we will increase the chance of export growth for U.S. agriculture much more than if we preoccupy ourselves with this 5 percent of World Bank and IMF and multilateral lending that happens to go to agricultural development which, as I have argued, can in most instances be of long-run benefit to U.S. agriculture anyway.

Mr. COBB. You mentioned that the current lending plans of many of the Latin American countries—for example, the development of sugar as part of their development plans—were an important part in their growth stategy, but the Senator asked a question—how can this be in fact an effective plan for these lesser developed nations if sugar production is in surplus in world markets and there's no denying, of course, that it's the Europeans' propensity to subsidize and also export sugar that is sabotaging these plans, but how can a plan that presumes to raise hard currency by further exacerbating the surplus in fact be a successful plan?

Mr. PAARLBERG. I agree with you that the hope of the tropical countries that are the efficient producers, their hopes to make good from their comparative advantage in sugar—those hopes may continue to be frustrated if the United States and the European Community keep in place the quantitative restrictions on imports into our markets that we now maintain to protect our domestic industry. But I wouldn't want to use our proclivity toward protectionist trade policies as a reason for telling them that they shouldn't proceed with their comparative advantage. It sounds to me like something I would not want to associate myself with. I think we should be honest and I think in that situation to consider agricultural policy change.

Mr. COBB. Mr. Hardy, the Senator was unable to prepare questions because we did not have your statement in advance—that's not a criticism but just a comment—so let me pose a question of my own.

I certainly agree as an economist that food self-sufficiency is a rather insane point of view, smacks very much of the idea that mercantilism that the best you can do is to feed your country and try to get along by yourself.

Surely, the promotion of hard currency export commodities in the third world in areas where it is not demonstrable that there is a comparative advantage but it is demonstrated that the govern-

ment itself simply wants to install certain types of development projects—we have cases of these that we've seen.

Would you comment on the political motivations behind many countries in wanting to develop certain types of agricultural industries?

Mr. HARDY. Well, you mean motivations other than sound economic analysis?

Mr. COBB. Correct.

Mr. HARDY. Well, one example is sugar cane development in Haiti. The prime motivation for that was not solid economics. It was the fact that in-laws of the Duvalier family owned some sugar mills and they needed to keep sugar production high and continue that in the central plain of Haiti rather than, as a chain of international experts had proposed, wanting to improve fruit and vegetable production in that part of Haiti. That's just one example I can think of. And all of the examples are not necessarily that venal.

There are some perhaps legitimate social concerns to take into account. The need to keep people productively employed and perhaps to get into commodity sectors that are labor intensive that might be a legitimate concern. But it would not, I think, support an international lending agency. I think the question, if you were making a loan by the IMF or some other multilateral lending agency, should be simply comparative advantage over the long term without any subsidization other than that involved in the loan itself.

Mr. COBB. Mr. Galston, would you care to comment upon the criteria that Mr. Hardy has commented on. Do you associate your own views with the endorsement of comparative advantages as the primary criterion for third world agricultural development?

Mr. GALSTON. With a couple of qualifications.

Mr. COBB. Could you please elaborate?

Mr. GALSTON. Certainly. Qualification number one is that in recent years the classic Richardian notion of natural comparative advantage has been challenged in a number of different ways. Certainly when you're talking about manufacturing and high technology, comparative advantage can be created through deliberate policy, including deliberate government policy. The notion that you simply inspect your natural resources, your land, and the quality of your human endowments and read off some chart of comparative advantage vis-a-vis other nations is something that made a heck of a lot more sense in the turn of the 19th century in England than it does in the late 20th century with the growth sectors of the international economy being what they are.

That is not to conclude the debate but only to open it on that point.

Secondly, while I have a great deal of sympathy for the economic theory underlying comparative advantage, it nevertheless—the case that it rests on certain empirical propositions, including the free flow of goods and services, and for example, if I were a Japanese senior official, I would be paying a lot of attention to the sustainability of my food supply in times of crisis and I might be willing to pay a lot more than the going world rate in order to have a domestic food sector that would more or less provide for national needs in the case of a severe interruption.

The alternative to that, of course, is the policy that was pursued during the 1930s by the Japanese, the attempt to sector off a portion of Asia as their prosperity sphere.

If I had a choice between those two policies, I would greatly prefer their current policy of domestic agricultural protection, even though it works severely to the disadvantage of American farmers, and I believe that the Japanese ought to be pushed very hard to relax it because I think they have a lot further to go before they reach their own private bottom line of what they are willing to yield in agricultural imports.

So with those two qualifications, yes, but, unfortunately, those two qualifications are not insignificant ones.

Mr. COBB. I understand in our hearing of a few weeks ago on the European Economic Community the question was posed—a speculative question—of why are the Europeans so intensely into political subsidy and one of the answers offered was that they had remembered the devastation of the two world wars and had a strong domestic political motive to be self-sufficient in food.

Would you comment on that observation? Do you think that that kind of political motivation operates in these countries that do heavily subsidize their domestic production against comparative advantage?

Mr. GALSTON. I think that's part of it and I would cite two other factors as well.

Factor number one, which is also operative in Japan, is that many of the incumbent governments have very heavy support in rural and peasant areas and are not about to adopt policies that would undercut that support. That comment, as I said, is as true of Japan as it is with many European governments.

Second, urban unemployment is well into the double digits in most European cities and the notion of embarking at this point on policies that would force significant percentages of agricultural workers and peasant owners off the land and boost the unemployment rate still further is not one that they can contemplate with equanimity and if I were a senior European official thinking about being forced to dismantle the current structure—although if I were an economist I would probably think one thing about it—but as a politician, I would probably think something quite different.

Mr. COBB. Mr. Paarlberg.

Mr. PAARLBERG. If I could just add another thought about the current agricultural policy in the European Community and why it's so generous to agricultural producers, when the Common Agricultural Policy was first established some 25 years ago, the European Community was of course a net importing region in most agricultural commodities and a highly protectionist policy was, for that reason, affordable to European Community taxpayers and protectionist restrictions in fact earned money for the European Community. They could collect revenue at the border. Of course, the protection offered the European producers was so generous that they responded with an outpouring of production and the Community is now moving in one product after another from being a net importer to being a net exporter. This gives me hope that the original protectionist bias in the Common Agricultural Policy will soon become unaffordable to the European Community taxpayers.

The European Community used to collect taxes at the borders to protect its producers. Now it has to provide generous export restitutions to protect its producers. The cost of those export restitutions will eventually run into some politically unacceptable ceiling and at that point the generous terms of support provided by that policy will have to change. And I think, incidentally, the United States can hasten the day when the European Community runs into that by ensuring that we keep our export prices competitive. Every ten percent reduction in the exchange rate of the dollar in relation to the European currency automatically obliges the European Community to spend an extra one billion ECUs, European Currency Units, on export restitution payments. We can force the European Community to tax taxpayers to finally start paying for their very generous subsidies that you described earlier by keeping our own export prices competitive.

Mr. COBB. That sounds like an interesting side benefit to the declining rate of the dollar.

You mentioned how you thought it was not the best approach for the United States to follow the measures in the FAIR bill which both Senator Abdnor and Senator Symms have supported.

What would you recommend be done within the framework of the multilateral lending agencies to encourage results that are sought by this bill?

Mr. PAARLBERG. I think we should use our money and our presence and our vote in those agencies to be as persuasive as we can arguing against objectionable loans that will support unneeded farm production and I think we're more effective in doing that if our representatives in these agencies had the freedom to argue, to persuade, and to present their views outside of the straitjacket constraints that are written into this sort of legislation.

Now it would seem that the views of the representatives in these agencies are not persuasive in that they bring out the legislative constraint of this kind that has its inspiration and its inception without concern of the recipients of multilateral lending support but instead in fact are concerned with the constituency here in the United States.

I have the feeling that as legitimate as the interests of the U.S. constituency might be, those interests are not well known and persuasive to the multilateral lending agencies. If the decision to make the loan by the multilateral lending agency is determined 100 percent by what's good for U.S. agriculture that the credibility of the U.S. participation in those agencies is reduced.

Mr. COBB. Mrs. Benson, I wanted to ask you and follow up—I thought you made a very important remark when you commented that the people in the rural areas are withdrawing into themselves, not attending meetings where they can discuss their problems with their neighbors and get support, psychological support as well as solve common problems.

What long-term effect do you see this having on the—you mentioned the moral fiber of the agricultural community. I'd like you to discuss that a bit more because I found that particularly interesting and I'm sure the Senator would also benefit by hearing you make that point very directly to him.

Mrs. BENSON. We are seeing such a change in rural America. Every town is seeing business after business close. And I would like to make the comment also that the changes in the FAIR bill would not be aimed at only helping agriculture, I think it would be aimed at helping all the workers in this country. We know how much agricultural production creates jobs and that every raw ag product has to be handled through the system and that would help the economy of this country.

What's happening in rural America, the stores are closing, we're literally seeing little towns become ghost towns. A study in Colorado is saying that any town under 2,000 is going to disappear within 7 to 10 years and that's going to make a very large difference in what's happening. Our tax base is dwindling. Our state government is at odds at what to do to help rectify the situation. Our taxes as landowners are increasing and yet we don't have the means to earn more to pay those taxes when our commodity prices continue to drop.

I refer so frequently to the study by Mr. William Heffernan and Judy Heffernan and I hope they have appeared before this panel at some time or other. They are rural sociologists in Missouri who have studied what's happening to farmers who are forced off the farm and it tells what's happening where the family is hurt, that they're going to the cities and also looking for work there, increasing the unemployment.

Last year during the Senate Agriculture hearings a gentleman came from I believe it was England and he asked the Senate Agriculture Committee to give very careful consideration to the farm bill and to what it would do to the social structure of this country. I found that interesting and, indeed, we are now seeing what's happening.

Mr. COBB. Thank you very much.

Senator ABDNOR. I just might add to that, if I can, we have held a number of hearings this past year and a half on how to revitalize rural America and, of course, the schools and medical people, not just farmers. For a while we had trouble getting the other groups because the farmers wanted to speak out, but eventually we got down to covering the whole broad area and the future is not encouraging if we don't reverse this, and no one that I've found at the hearings had any quick, easy answer, I can tell you that, and these sort of practices we're talking about today does nothing to contribute—that just contributes to the problem.

I just can't help but realize how much the farm program is going to cost us, but what it might be like if we didn't have that kind of almost unfair competition from these people that we have to compete with. We had a hearing a little over a week ago on the effects of our agriculture on the nuclear explosion in Russia. I don't think it's going to have that much of an impact, but at least from what we were able to ascertain from our witnesses at that time, and the markets were fluctuating up and down and we wondered what the outcome would be.

It's interesting to note—sad as that is and it was most unfortunate, but that portion of the country that might be affected doesn't go to the market. It makes you wonder if maybe you wouldn't be saving the government an awful lot of money if they would give us

a chance to compete in world trade and not be looking to the government for all those supports. I don't feel guilty at all. If they want to play that way, that's making the problem that much more difficult for farmers who have to survive. By saying that it's making life pretty difficult for the small towns. My town I learned the other day is now 334 people. I used to tell everybody 370, but I've gone and now they're making news now when they give the new population, but that's what's happening. And that's small, small I know, but this is going on all over America, I guess not just in the Midwest.

I'm sorry but I had something I just had to go to, plus a vote just now. We do appreciate the fact that you were willing to come and your testimony will certainly be kept and used and see if we can't start the momentum on this type of a problem.

Mr. COBB. Thank you all very much for coming today. All of your remarks will be part of the record.

[Whereupon, at 4:10 p.m., the subcommittee adjourned, subject to the call of the Chair.]

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